

**FIRST  
PRINCIPLES**  
**In Morality and Economics**

**Volume VI★**  
**1960**

**NEOCLASSICAL IDEAS ON  
GOODS, VALUE, PRICE, INTEREST AND  
EXPLOITATION**

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- 1955 *Essays Against Sanctimony And Legalized Coercion*
- 1956 *Essays On The Peerless Mosaic Law*
- 1957 *Harmony Of Morality And Economics*
- 1958 *Neighborly Love And Ricardo's Law Of Association*

### FIRST PRINCIPLES IN MORALITY AND ECONOMICS:

- 1959 *Moral Aspects Of Money, Banking And The Business  
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- 1960 *Neoclassical Ideas On Goods, Value, Price, Interest,  
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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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VOLUME VI

JANUARY, 1960

NUMBER 1

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## On Beginning Our Sixth Year

With this issue we begin our sixth year.

For the first four years this monthly was published under the title, *Progressive Calvinism*, but that title was criticized by non-Calvinists, on the ground that it claimed for Calvinism what was not restricted to Calvinism; the critique was, in effect, that the title was parochial, but that the contents were not.

Therefore, the title was changed in the fifth year to *First Principles in Morality and Economics*. In conformity to the change in title, further specifically denominational material was withheld. In that regard there has been a change in content as well as in name.

Immanuel Kant declared that for a moral law to be valid it had to be *universally applicable*. That is the aim of the morality taught in *First Principles* — that it be valid for a Confucianist,

Buddhist, Mohammedan, Hinduist, agnostic, atheist, or Judaist, as well as for a Christian, whether Catholic or Protestant. But not only is the approach herein based on the morality taught in the Hebrew-Christian Scriptures, *consistently interpreted*, but it is also unfeignedly the approach of orthodox Christianity, in religion as well as in ethics.

As readers also know, the economics taught herein are those of the *Neoclassical* school. This means that our economics are based on the work of Adam Smith and David Ricardo, but modified (as it urgently needed to be) according to the work of William Stanley Jevons, Carl Menger, Eugen von Böhm-Bawerk and Ludwig von Mises. It is especially the economics of the latter three, the outstanding exponents of the famous Austrian school of economics, which is followed in *First Principles in Morality and Economics*.

The economics of those men are consistent with the morality of the Hebrew-Christian religion (probably without that being their specific intention, because they were writing as scientists).

Current issues of *First Principles* are, unavoidably, not always readily understood *unless the earlier issues have been read in sequence*; but then the reading should be easy. Paperbound copies of the first five years are available at three dollars a year. Those who are interested in following the presentation carefully should consider having access to the earlier issues.

Popular religion is guilty of many "extravagances" — exaggerated propositions — and much of modern economics is confused. Our aim is to promote morality and economics, so that there may be universal personal well-being and social health and harmony. The patience of our readers is petitioned in the many instances in which we fall short of attaining those objectives.

## **Although There Are Fewer Rich Than Poor, There Are More Creditors Than Debtors**

Because there are fewer rich than poor, the common inference is that there are also fewer creditors than debtors. But the infer-

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ence is erroneous. Creditors outnumber debtors. It probably should be added that the error is a natural one.

1. Everybody who carries life insurance directly or in a group life insurance plan is a creditor. He himself or his heirs will receive a future insurance payment. His right to it makes him a creditor, and he looks upon himself as a creditor, because *something is owed to him in the future*. He, or his employer, currently makes the required premium payments to the insurance company. The insurance companies, few in number, are really debtors of mountainous size with a large number of creditors, their policyholders. It is readily conceded that the capital of the stock insurance companies is owned by their shareholders, but companies have many, many more policyholders than stockholders.

2. The building and loan associations have many debtors. Maybe the average debtor to a building and loan association owes the association \$5,000 on a mortgage loan. But the average savings amount deposited by savers in building and loan associations will certainly not be \$5,000. Maybe the average is closer to \$500. On that basis the creditors of the building and loan associations (the depositors) outnumber the debtors of the association (the borrowers) 10 to 1.

3. The banks appear to many to be powerful and rich creditors, and they are. There are big stockholders in banks and also big debtors to banks. But here again the creditors outnumber the debtors because banks have thousands of depositors. Every depositor, as depositor, is a creditor of the bank. It is true that the deposits of *some* depositors consist of borrowed money, but these are only *some* of the depositors. But *every* depositor is a creditor. Because the category, *every* depositor, must exceed in number the category, *some* depositors, here too the creditors outnumber the debtors and very greatly.

4. In a sense, every person who possesses money, in his purse or in the bank, or who has a future "call on dollars" owed to him at a future date, is a creditor. The money which a man has in his "stock of money" for emergencies, or to use until his next payday, is a claim against future goods. The sixty dollars a man has in his pocket with which to buy a suit of clothes makes him a "creditor," in a sense, against society. He is a "creditor" until he surrenders the money for the suit.

\* \* \*

Politicians make a spectacular error when they hold the opinion that the number of creditors is no greater than the number of rich. If they *think* that they are helping the larger number of their constituents when they (the politicians) favor inflationary measures, they are in error. For a politician to favor inflation is to favor the minority of his constituents (debtors) at the expense of the majority (creditors).

The favoring consists in making it "easier" for debtors to pay their creditors, or in other words, to adopt policies which raise prices. Doing this consists in issuing more and more money for one or another reason. Increasing the quantity of money raises prices. When a debtor borrows, he can buy (say) 400 bushels of wheat with the \$1,000 that he borrows; the price of wheat is \$2.50 a bushel. But when the debtor must pay back the \$1,000, then the price of wheat — because of inflationary policies of politicians — may be \$5 a bushel. Then the debtor needs to produce only 200 bushels of wheat to pay back the 400 bushels he originally borrowed. The debtor has thus been greatly aided.

Inflation is immoral; it violates the Eighth Commandment, Thou shalt not steal. But it is also unjust; it usually helps the rich more than the poor. It would also be theft and unjust if it helped the poor more than the rich, but there is a peculiar heinousness about helping the rich against the poor, and the strong against the weak. Who is there who will feel at liberty callously to defend it?

\* \* \*

The error which consists in confusing the rich with the creditors is not peculiar to politicians. The politicians merely reflect public opinion, and the prevailing *public* opinion is that inflation helps the many poor and hurts the few rich. The public would do well if it stopped confusing the rich with creditors, and if it came to a clear awareness that inflation hurts creditors and that the creditors are practically everybody.

The Hebrew-Christian Scriptures correctly describe (repeatedly) what is occurring in this inflation confusion. The program of the "public" is to hurt the rich by inflation, but they really hurt themselves. The Hebrew-Christian Scriptures say: "Whoso diggeth a pit [for his neighbor], shall fall therein [himself]." (Proverbs 28:27a) A classic case of this is inflation-

ism. When the "public" digs a pit, by inflation, for the rich, they (the members of the public) fall into the pit themselves as *creditors*.

## The Full Meaning Of Socialism Is Not Easily Understood

Definition of *socialism* in a dictionary or an encyclopedia, despite accuracy and length, will not reveal the full and varied meaning of *socialism*. The writer was troubled for years with uncertainty about its exact meaning; he at that time knew that he did not know what he should know. Even after he eventually thought he understood what the term, socialism, means, he has progressively discovered that his understanding was not yet complete. New phases and implications have almost regularly come to his surprised attention. Others may have similar problems and difficulties.

The contrasting term to socialism is *capitalism*. Some might say that the contrasting term is *liberalism* in the old sense, namely, maximum freedom of individuals (except no freedom to do wrong).

When a number of liberals (or capitalists) get together, it is not long before some suspect that the others are tainted either a little or seriously with socialism. The question which naturally arises is: are there half-breed socialistic-capitalists, and capitalistic-socialists? In a special sense, there are such people. This is readily explained.

There are socialists who are so only in a *production* sense; there are also socialists who are so only in a *distribution* sense; and there are socialists who are socialists in *both* senses.

Those who are socialists in a *production* sense believe that the organization of society should be planned and controlled *centrally*. They do not admit that the consumers, as a multitude, should control production, because then there will be "chaotic competition." Socialism, in this case, is a definite system for "ordering society." Such socialists believe a centrally controlled system is more productive and orderly than a market-controlled system, wherein the individual consumers are sovereign. Socialists of this type are not necessarily opposed to disparities in income. They have their eye focused on *control* rather than on *money*. *Power* rather than *profit* is their goal.

In contrast, those who are socialists in a *distribution* sense have their eye focused on the *money* and not on the *control* phase. These socialists do not insist on central control of production. They may even believe, genuinely, in a market economy. They may be convinced that a free market and private ownership of capital increases production. Therefore, they are for a free-market system, and may be as much opposed to government controls as are genuine liberals or capitalists. How then do socialists of this type keep their eyes focused on *money*?

The term *distribution* in this connection refers to what each participant in the economic process gets; it refers to *how* the production is divided — *distributed* to each participant as his share of the proceeds.

Imagine a small society *organized* on a free-market basis as these socialists wish it to be. Every man does his best under the incentives created by the free market. Self-interest spurs the citizens to be active and productive. The community is consequently prosperous. But then "socialism in distribution" steps in. A steeply graduated income tax is applied. Mr. X who, under the stimulus of the free market, had undertaken great risks, performed great services in production and marketing, and who as his part of the proceeds received \$50,000 for his achievements, is now taxed by progressive taxation so that he retains say only \$10,000. Mr. Y who for less effort, less skill, less risk and less production had earned \$20,000 is taxed so that he, too, earns \$10,000 net. In other words, the *socialism*, the equalization, *enters the economic structure only in the distribution phase*.

We have referred in an earlier issue to a mayor of a big city who was a "distribution socialist" only, but he travelled, openly, under a socialist label. In a serious labor dispute between a corporation and its employes, the mayor boldly took the side of the corporation. He did not want union pressure to be used against the management. He wanted the management to run the business for profit only, untrammelled by other motivations. He was sure that that was the way society should be "ordered" or organized, because it resulted in the greatest production and prosperity for the citizens of his city. But how, then, was this mayor a socialist? Certainly he was not a socialist in the production sense. But just as certainly he was a socialist in the distribution sense, *because he*

*avored income taxes which finally would level income.* He was a socialist in taxation, in a *money* sense, rather than a *control* sense.

The trouble with this latter idealistic scheme of theoretical socialists is that it will not work. It assumes that men are fools. It assumes that they will continue to work furiously hard even when they know that the extra reward for extra labor will be taxed away. Such men, it is assumed, will run like jack rabbits after a carrot, as if not realizing that their achievement will not benefit them, because of the fact that just when they are ready to consume the reward, it is taken away from them.

Maybe the combination (1) a free-market system of production plus (2) socialism in distribution is the most *corrupting and impoverishing* type of socialism that there is. It first pretends incentives, but destroys them in the second step. The citizens will soon be wholly disillusioned.

Russian socialism is maybe mostly of the production type, and consequently cruel and oppressive. There is *central control* in Russia. But it is also alleged that rewards in Russia are variable and that incentives are being more and more used to increase production. If that is true, then the distribution aspects of socialism in Russia are less in effect than are the *production* aspects.

Probably in the recent experiment in England with socialism, the production aspects have not been so prominent as have been the distribution aspects. The British have been taxed severely. The United States also is a semi-socialist society in a distribution sense.

A thoroughbred socialist is one who believes (1) in *central* control of production, and (2) in *equal* distribution; both.

A thoroughbred capitalist is one who believes (1) in a free market, and (2) variable income distribution in proportion to productivity and service; both.

But there are half-breed socialists and half-breed capitalists.

When unable to classify some friend of yours about whose ideas you are uncomfortable, because you think they are left-wingish, give some thought to whether he is off-base in your estimation on the ground (1) that he favors some form of *central* control rather than a free market, or (2) that he is an equalizer of incomes and a discourager of incentives by *progressive taxation*. Both (1) and/or (2) are aspects of socialist thought.

## Some Inquiries About The Business Outlook In 1960

### The Stock Market And Business

If a man really believes business will improve, his next thought is how to cash in on the idea. About his first recourse is to buy some stock, either of his own company or a similarly situated company, and "make a profit" from the probable rise in the price of the stock, which rise should occur because of a prospective improvement in business.

But if a man really believes business will deteriorate, his next thought will be how to reduce any loss to himself. If he owns stock, he will give consideration to selling it before others do and before the price will go down.

The New York Stock Exchange is, therefore, a sensitive barometer of the expectations of business men. It is an institution where business men reveal, or betray, their most private thinking. There are, naturally, also routine investors, buying and selling stocks, without much knowledge what it is all about. But offsetting these novices, there are also experts who do nothing except buy and sell stocks—for an attempted profit (but which may turn out to be a loss).

The New York Stock Exchange is probably the *greatest market* that has ever existed in this world. It is a place where big and small, wise and foolish, trade. By their actions there, they reveal their resources and their needs, and what they really expect under the circumstances.

But *cause and effect* are intermingled on the New York Stock Exchange. Grant that opinions "outside of the market"—opinions of a country banker, or a farmer, or an industrialist, acted upon by them—influence the trend of the market. But, in a reverse sense, the trend of the market influences their thinking. If the market "booms," people tend to become optimistic, and they begin to buy too, making the market go still higher. If the market declines, people become pessimistic, and they begin to sell too, making the market go still lower.

\* \* \*

Illustrations of the effect on business of the trend of prices on the New York Stock Exchange are not hard to find. In the



latter half of 1957 and the early half of 1958 prices on the New York Stock Exchange declined severely; in many cases, quotations were 40% under those of a year earlier. What was one of the consequences?

A business man, who in the summer of 1958 saw his company's stock selling for \$60 which a year earlier brought \$100, was probably no longer expansion minded. A business man who had hoped to expand, and finance the expansion by selling additional stock at \$100 per share, only to find that when he thought he was ready he could get only \$60 per share, would almost certainly abandon his plan. Such decisions lessened construction activity in 1958. Companies in 1958 in the construction industry generally experienced an unsatisfactory year.

Nevertheless, at the end of 1958, *because of inflationary action of the monetary authorities*, the stock market was much higher than at the beginning of the year.

\* \* \*

In 1959 the market, *as a whole*, declined somewhat. The limited number of stocks in the Dow-Jones Industrial Average do not reflect the whole market well. A more reliable index is the market value of the larger number of underlying securities in large investment trusts, such as United States & Foreign Securities, Tricontinental Corporation, Adams Express. The trend of the market value of the broader lists of stocks held by companies of this type are evidence that the stock market did not boom generally in 1959.

\* \* \*

This brings us to 1960. The market may boom in 1960, or it may decline severely. We shall consider only *one* factor which will influence the market. This is probably as important a single factor as any, but it may be overwhelmed by other factors also of importance. The factor we shall consider is the *interest rate*. By interest rate we here refer to the *loan money rate*. For purposes of definiteness, we select the interest rate on *prime commercial loans*. The rate is currently 5%.

The loan money market is "tight enough" so that banks *insist* that borrowers carry cash balances equal to 20% of the loans. That means that borrowers can actually use only 80% of

the loan. That being the case, the *real* cost to the banks' best customers who are the *prime* borrowers, is (5.00% divided by .80 or) 6¼%. For borrowers of less financial strength than the prime borrowers, the rate will be more than 5%. Probably the average customer pays one-half percent over the prime rate, or 5½%. If 5½% is divided by .80, the real rate is 6.875%. Money that costs that much is expensive.

The "smart money" on the New York Stock Exchange will give serious consideration to the prevailing interest rates, and the probable trend of those rates.

The stock market has never been able to *continue long* to make headway against a tight loan money market and high interest rates. The question is: what constitutes a *high* interest rate?

#### **The Effect On Business Of The Ratio Of Commercial Loan Rates To The Natural Rate Of Interest**

What is meant by the natural rate of interest was explained in considerable detail in the preceding issue (December 1959).

The natural rate of interest is *not* controlled by the ratio between selling prices and costs; nor by the productivity of capital; nor by the quantity of counterfeit money, in the form of circulation credit, injected into the monetary structure. The natural rate of interest is neither a production nor a monetary phenomenon, but a psychological phenomenon—to wit, the amount of the discount that people apply to future goods as compared to present goods. (See the December 1959 issue.)

For the natural rate of interest we semi-arbitrarily used the figure of 5%, and put the probable range at between 4% and 6%, and the extreme range between 3% and 7%. There are, as was indicated last month, no quotations on the natural rate of interest. It is a reality, but it is not recorded.

The natural rate of interest is the rate at which the general public is willing to reduce current consumption so that capital be accumulated. And the general public will certainly have its way on this subject. Its opinion in this respect is massive, monolithic, decisive—eventually.

The natural interest rate controls the eventual return on capital. If that rate is 5% (the figure here being used), but if the cost

of money in the money market is almost 7%, then whoever borrows at that rate runs some hazard that he will be squeezed between the 5% natural rate which he can "earn" if he is an average operator and the almost 7% money rate which he contracts to pay.

High money rates are a headwind for business. Low money rates are a tailwind for business. The owners of "smart money," buying and selling in the New York Stock Exchange, are well-informed on that fact.

The trend of money rates in 1960 will therefore eventually, if not soon, have an effect on the trend of the stock market and of business.

### The Feebleness Of Governments When Fighting Economic Law

The United States is "off" the gold standard. It is illegal for citizens to own gold. But the power of a government does not go beyond its borders, and so, whereas the United States is *domestically off* the gold standard, it is nevertheless *internationally on* the gold standard which will control the course of events.

For two reasons the United States is currently losing gold:

(1) Because it is giving away annually about 4 billion dollars in foreign aid; and

(2) Because some other countries have slowed up their rate of inflation, especially countries in western Europe, whereas we have not slowed up inflation in the United States in a parallel degree. They export more; we export less; we therefore lose gold.

These two causes for losing gold will soon have to be recognized by the people of the United States, and it may be expected that both these policies will, again later if not soon, certainly have to be reconsidered and changed. The "do-gooders" and the inflationists in the United States will have to bow to *economic law*, which is something which is not controllable by citizens nor statesmen.

\* \* \*

The trend of the gold stock in the United States is shown in the following chart. Between December 31, 1957, and December 31, 1959, the decline in our gold stock was \$3.325 billion. The average rate of decline in those two years was \$138 million

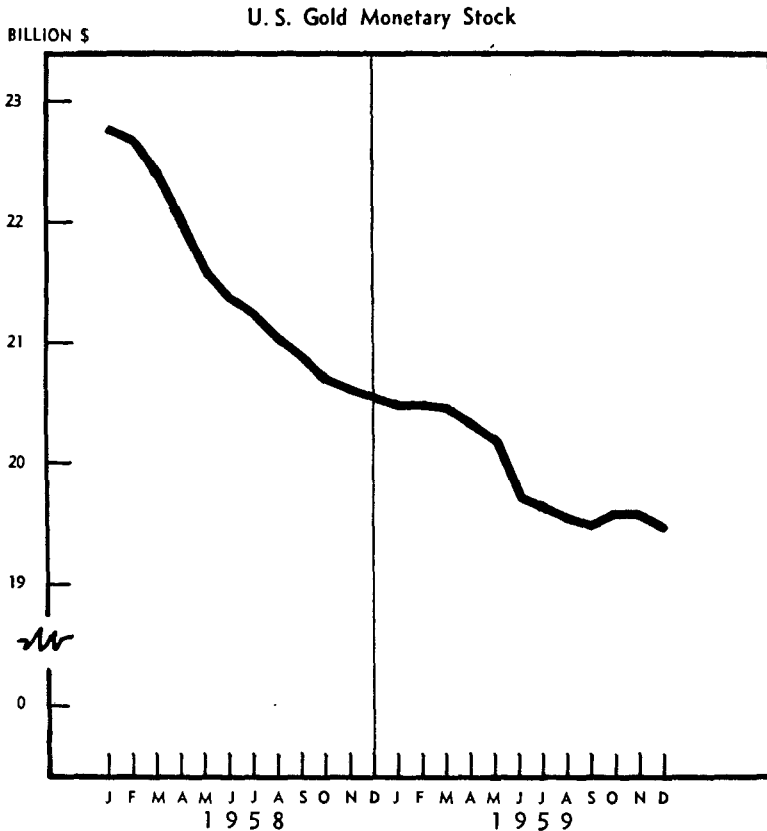
per month. The following table shows the gold stock figures and the monthly changes.

	U. S. Gold Monetary Stock (Million \$)	Increase (+) Decrease (—) (Million \$)
1957, December	\$22,781	
1958, January	22,784	+ \$ 3
February	22,686	— 98
March	22,394	— 292
April	21,996	— 398
May	21,594	— 402
June	21,356	— 238
July	21,210	— 146
August	21,011	— 199
September	20,874	— 137
October	20,690	— 184
November	20,609	— 81
December	20,534	— 75
1959, January	20,476	— 58
February	20,479	+ 3
March	20,442	— 37
April	20,305	— 137
May	20,188	— 117
June	19,705	— 483
July	19,626	— 79
August	19,524	— 102
September	19,491	— 33
October	19,585	+ 94
November	19,566	— 19
December	19,456	— 110

Although citizens may not own gold, the Federal Reserve Banking system, under which we live, requires that the banks maintain gold reserves in a certain ratio to their loans and discounts. This has a bearing on the business situation.

#### This Country's Stock Of Gold And The Loan Money Rate

Because (1) the United States has a fractional reserve monetary structure (only about one dollar of gold is needed behind each five dollars of commercial loans), and (2) because the United States is steadily losing gold, therefore the quantity of loans outstanding is subject to a "leverage," forcing a severe shrinkage of loans, all other things being equal. (Of course, all other things are never equal, but this is a digression from the present analysis.) That means that, if one million dollars worth of gold is exported, loans must shrink at least five million dollars, *ceteris paribus*. With the population of the country growing, and with the strong



inclination to expand which is habitual in this country, a shrinking supply of loans inevitably results in a tighter loan money market; consequently, the loan money rate, which is the rationing device to allocate the supply where it is most wanted, is firm and has been rising. Only those businesses which are able, because of favorable circumstances and skillful management, or those businesses whose management suffers from optimistic hallucinations, will consider themselves willing and able to pay for relatively costly loan money. The others drop out, because the rate is too high for them. They, of course, reduce their operating and expansion programs accordingly. When they "cut back," their earnings are likely to decrease; when earnings decrease, the shares of the various companies look less attractive as investments, and their prices go down.

The facts outlined in the foregoing mean this: *inflationism in the United States is presently again hitting an important barrier, namely, high loan money rates. Depending on when and how that is resolved (be it by sound or unsound monetary methods) the activity of business and the trend of markets will be affected.*

### **The Possibility Of Further Inflation**

We have been looking at only one phase of the business outlook in 1960. The analysis presented is not comprehensive, and there are no conclusions or "forecasts." There are many ways to "inflate" more. The motivation to inflate is especially strong in an election year. Under such circumstances, it is possible to lose gold, but nevertheless increase loans (circulation credit), because reserve requirements are eased; or the gold loss may end because countries abroad might generally begin to inflate faster than we are in this country; or we may reduce foreign aid; etc., etc.

But not everything is rosy for 1960, even if sound policies are re-established. A mere transition from unsound policies to sound policies itself would cause adverse results during the transition.

## **The Good Fortune That Interest Has Two Meanings, One Narrow And The Other Broad**

When a layman in economics speaks of *interest* he means interest on *money loans*. This is the narrower definition of interest.

When a professional economist speaks of *interest* he may mean in a specific case the same as the layman means, but it is possible that he refers to interest in the broad sense. Then he refers to *all income other than remuneration for labor*. This means that *interest* includes (1) rent on land; (2) earnings on stocks; (3) interest on money. (See the December 1959 issue.)

A socialist would agree with the professional economist and say that that broad definition defined *interest* as being *all unearned income*. After some thought, a socialist may be pleased that economists look upon interest in a generic way; he may say to himself: "I am opposed to all income *except income on labor*. I am against such other income whether it is called *interest* or whether it is called *unearned income*. But I prefer to call it *unearned income*. The word *unearned* helps me challenge such income."

The term, *unearned income*, which is universally in use should be abandoned, and *interest* should be substituted for it. The term, *unearned income*, sounds bad semantically. The spontaneous reaction to the idea of unearned income is: why should anyone be entitled to *unearned income*?

The word *unearned* is a misnomer, because the fact is that land does not *earn* rent; that capital does not *earn* profits; that money does not *earn* interest, in the sense that any of these puts forth effort or obtains a return commensurate with its *productivity*. *There is, hard as it may be to believe, no causal relation between physical productivity of land or capital with interest.* An illustration will make readers aware that that is true.

Certain machinery may make labor ten times as productive as it was previously without the machinery. One machine with one man to operate it may yield what otherwise required 10 men to produce. Let us assume the machine costs \$10,000. Let us assume the annual wage of each of the ten men is \$5,000. Together, their wages are \$50,000. After the machine exists, the owner of the machine only pays one man, that is, he disburses only \$5,000 and of course his machine gradually wears out (depreciation) and must be replaced. Does the owner retain almost \$45,000 for the production of the machine (an amount equal to the saving of the labor of 9 men, but less depreciation)? If so, his return would not be the ordinary 5% or even 10 or 15% on capital, but would be almost 450% (\$45,000 divided by \$10,000 or the cost of the machine, less depreciation). Now everybody knows that such returns are not realized in business, or if so, they are extremely temporary; or else the man who has the machine has an absolute monopoly.

Something altogether different from *productivity* or *use* must therefore be found to explain *unearned income* or *interest*, whichever word is used. That something is the *discount for time*. The man who owns land, or capital, or money which he relinquishes to others *loses the opportunity of the present consumption* of what he loans out, and he must wait until the land is sold, or the capital is depreciated or sold, or the money is repaid. And because universally (for all practical purposes) men regard a future good as worth less than a present good, they demand that something be added to the future value to make it worth the present value.

In order to convert the value of \$1,000 a year from now into a present value, men divide the \$1,000 by 1.05 (or by some other divisor) and obtain \$952.38. In other words \$952.38 today is worth \$1,000 a year hence. If a man relinquishes \$1,000 to you today as a loan, or an investment, he wants \$1,050 back a year hence; to make what he gets back *in the future* equal in value to him for what he relinquishes now he insists that \$50 (or another amount) be added to the \$1,000 he loans or invests.

Now the good fortune that derives from calling all income (under competition) other than the remuneration of labor, *interest*, consists in this:

1. That there is recognition of the *common* underlying *cause* of this income, namely, discounting for time;

2. That the word *interest* does not have the unfortunate semantic implication that *unearned* income has — and neither *earning* nor *productivity* has finally anything to do with this income. *Productivity*, in relation to interest, is *irrelevant*; and finally,

3. That those individuals who erroneously believe that the Hebrew-Christian Scriptures forbid interest become aware that they are obviously inconsistent when they fail to distinguish interest in the narrower sense and interest in the broader sense. If Hebrew-Christian morality were against interest in the narrow sense, it would (in order to be consistent) also have to be against rents and profits, that is, interest in the broader sense. We know no one who declares that the Hebrew-Christian Scriptures are against either rent or profits. But when it is obvious that rent on land, profit on capital and interest on money are really the same thing, then one must be *for* or *against* all three.

### **What About That Frequent Statement, "You Cannot Say One Economic System Is More Christian Than Another"?**

In pulpits and in the press the statement is occasionally heard, "You cannot say one economic system is more Christian than another."

In Western countries that statement appears to be a disguised attack on the prevailing system, namely, on capitalism.

Nobody can be morally indifferent to the "economic system" under which he lives. No man can escape taking a position in



regard to economic systems. The reason is obvious. Economic systems differ; one system is right or at least better; another system is wrong or at least worse, or vice versa. The great controversy of the age pertains to economic systems.

There are degrees of differences between these systems, but the basic issue is between capitalism and socialism-communism. If capitalism is right, socialism-communism is wrong.

Neither convinced socialist-communists, nor convinced capitalists ever talk about an economic system being morally indifferent. Traditionally, capitalists have execrated socialism-communism; and zealous socialist-communists curse the capitalist system. It is the confused or the insincere who say, "You cannot say one economic system is more Christian than another."

The two systems, capitalism and communism, can be easily contrasted:

#### Capitalism

1. Private ownership of property
2. Free exchanging of property

#### Socialism-Communism

1. No private ownership of property
2. No free exchanging of property

What does the Hebrew-Christian Scripture teach on these two subjects?

Scripture does not dispute the morality of the ownership of private property. Such ownership is protected by the commandment, Thou shalt not steal. Capitalism is in this regard based on Scripture.

In regard to the second basic characteristic of capitalism, namely, free exchanging of property (known to economists as a free market economy), capitalism again has the support of Scripture. The *free* exchanging of property has this fundamental characteristic — it agrees with the Sixth Commandment, which forbids violence and coercion and compulsion by one man or another, or a group of men on any of its members or nonmembers. People under capitalism *voluntarily* make exchanges according to *their own choices*. This is what the capitalist system requires. The Sixth Commandment, Thou shalt not coerce, is the cornerstone under the *free* market.

But socialism-communism professes the contrary principle, namely, compulsion. You may not own property, and of course

then you may not voluntarily exchange it; compulsion, coercion, regulations, laws, restrict choices in practically every aspect of life.

If there is anything Moses and Christ taught in regard to this life, it was that the members of a society were not to be coercive toward each other. The only coercion they permitted in their system was the coercion needed to restrain positive evil — murder and violence, adultery, theft and fraud, falsehood, and covetousness.

Capitalism, then, is founded on the Sixth and the Eighth Commandments. Socialism-communism is opposed to the Sixth Commandment and in effect annuls the Eighth Commandment. How then can people say, "You cannot say one economic system is more Christian than another"?

## **A "Mechanism" Through Which The "Wrath Of God" Operates In Economics**

The Hebrew-Christian religion, which is the dominant religion in the so-called Western world, teaches that there is a "wrath of God" against evil. The question arises how the "wrath of God" can be effective against evils which are perpetrated by governments. We have in mind the evil of circulation credit which is a public or governmental evil.

Certain forms in which the "wrath of God" can be manifested immediately suggest themselves: (1) A natural calamity as famine, plague, earthquake, and other catastrophies; (2) A scourge in the form of a hostile foreign power, which will devastate and oppress the country guilty of an evil; (3) The enervation of the character of the citizens, or the general deterioration of their moral fiber. The Hebrew-Christian Scriptures record instances in which these forms of the "wrath of God" have manifested themselves.

But there is an additional form by means of which the "wrath of God" is manifested. The specific problem to which we address ourselves is: *How or in what form* does the wrath of God manifest itself as a penalty against the issuance of circulation credit, which is the cause of the business cycle.

\* \* \*

In matters pertaining to the wrath of God, the question arises whether God always works through means or whether He sometimes operates directly. The better answer appears to be that *all*

of the dealings of God with men are *through means*. The three items listed in the foregoing are *means* through which God might manifest His wrath.

In matters pertaining to the natural world, men have come more and more to the acceptance of the idea that there are unchangeable natural laws (except in the case of miracles), for example, changes in weather are now considered to be explainable by physical laws; similarly in the case of contagious diseases. In a general way men expect these laws to continue in effect and coerce men into obedience or grind them to destruction.

This acceptance by men of the invariability of natural law is not matched by a corresponding acceptance in the field of morality and ethics. The consequences of disobedience of the moral law are by no means so invariable nor so prompt as are violations of physical law. Consequently, as Solomon said, "Because sentence against an evil work is not executed speedily, therefore the heart of the sons of men is fully set in them to do evil" (Ecclesiastes 8:11). In modern English, the idea expressed in the quotation is that: because the penalty for unethical conduct is not prompt (as in the natural-law field), therefore men think it is not unprofitable for them to engage in evil; they hope to escape consequences or that the consequences will be long delayed.

Possibly a physicist would be able to formulate the most fundamental law of physics on which other physical laws, in the final analysis, depend. If that is possible, it becomes interesting to search for the fundamental law, in the social-science field, on which the moral law rests. If that fundamental law existing in the very nature of things and underlying the moral law can be stated, then it will be possible to understand the reason why the moral law cannot be violated without there being a penalty, in the same way that a fundamental law against sanitation cannot be violated without there being a penalty.

\* \* \*

The fundamental law in the social sciences and in morality is that men will *pursue their self-regarding interests* and *their own self-preservation*. Everything alive has in itself something which strives for its individual welfare and the continuance of its life. An elm tree ordinarily develops spreading branches close to the ground. But an elm tree whose misfortune it is to be situated

just north of a high bridge, and consequently which is out of reach of sunlight, will grow a long trunk, slender and practically branchless, in a desperate endeavor to reach the sunlight. Every plant, beast and man seems to have in itself that fundamental will to survive, to attain the greatest self-development, happiness and welfare.

If then there is a *fundamental* law in the social sciences, that law, it is believed, is the law of *self-preservation*, and *self-development*, and the *pursuit of self-regarding interests*.

\* \* \*

If the issuance of circulation credit is an evil; if it is authorized by a powerful government; if it is true that the wrath of God operates against evil; if it is true that God manifests himself through means; if those means can consist in a physical calamity, a foreign scourge, or the enervation of a people, but if none of these is operative then is it possible nevertheless that the wrath of God against evil in the field of economics can be manifested; and if so, will it be revealed by that fundamental law operating in the social science field, namely of self-preservation, self-development, and the pursuit of the self-regarding interests? To this question the answer, we believe, is *yes*.

Circulation-credit expansion, having been authorized by government, will therefore not be punished by government. Punishment must come from another source.

The form in which the punishment will manifest itself is in a depression. The circulation credit itself will first cause a boom. The boom is certain to be followed by a depression, and so the wrath of God against circulation credit is manifested in that manner. But the question still remains: What is the *mechanism* by which the depression is brought on? It is at this point that the fundamental law of *the pursuit of self-regarding interests* enters the situation.

Because circulation credit results in businessmen miscalculating, by over-estimating their markets and their resources, they initiate projects which pertain more to the future at the expense of the present than the consumers will tolerate. To endeavor to stimulate capital formation by the issuance of circulation credit and low interest rates will be unsuccessful eventually, because instead of waiting for the *future* consumer goods to be obtained from

*present* capital formation, the public instead will want *current* consumers goods for which it does not wish to wait.

The public says: "Why should we deny ourselves now so that our children in the future may live so much better than we do now?"

Consequently, before expansion projects really based on nothing more than the issuance of circulation credit can be accomplished, it becomes evident that the public will not forgo current consumption sufficiently so that the proposed expansion in capital formation can be completed. The projects become unprofitable, and have to be abandoned; the public, in short, finally enforces its own will onto the economic community. The "wrath of God" then against circulation credit operates in a form which consists in individuals pursuing their self-regarding interests by demanding more present goods and refusing to wait for future goods. The theft so cleverly perpetrated through circulation credit has finally been subjected to the "wrath of God" exercised through the law of self-preservation and legitimate self-interest by the individuals who constitute the public. Underlying the moral law and the penalty for violating it is an indisputable fact of creation, inherent in the nature of all living beings, to wit, the will to survive and to attain the greatest individual welfare. If that in-created nature is violated, the reaction can correctly be described as the "wrath of God." There is no escape *possible* when the laws of morality, inherent in creation, are flouted.

The sequence is: (1) self-deception and theft by means of circulation credit; (2) miscalculation and boom; (3) action by individuals to protect their self-preservation and their welfare, as they see it; and (4) an inescapable depression. Again the law holds: "our sins will find us out."

## Money Cranks

The world has today and will probably continue to have many well-intentioned, but nevertheless dangerous, money cranks.

Money cranks have one essential characteristic. They wish to solve the economic problems of the world by *increasing the quantity of money*.

Men with substantial knowledge of money problems feel obligated to resist the programs of money cranks. Bankers generally resist the program of full-fledged money cranks. However, when

bankers oppose money cranks, but nevertheless favor putting out circulation credit, they are inconsistent.

Three different positions may be considered:

1. Unlimited money (and/or credit) expansion; this is the demand of money cranks;

2. Controlled (and therefore, presumably *moderate*) money and credit expansion, as by the banks when they put out circulation credit; and

3. No further money and credit expansion whatever, except as there is more mining of gold, or transfer of gold from industrial to monetary uses.

These three positions are essentially: (1) unrestricted credit expansion; (2) banker-regulated credit expansion; and (3) no *further* credit expansion at all.

A man is hardly consistent if he condemns an act merely on the ground of the *amount* rather than the *principle*. If a little circulation credit is good, then why is not more circulation credit still better. No respectable banker will approve the program of money cranks, but, by their disapproval of money cranks, bankers have really condemned their own issuance of circulation credit. A man, therefore, must be in one of two camps: (1) that of honest money, or (2) that of money cranks, no matter how well-intentioned, respected and wealthy the advocates of a money scheme may be.

Men who are informed on money problems sometimes lament that the "public" does not understand such problems, and they hanker to take the problem out of the control of the common man and leave it to the monetary experts. But there is no un-understandable mystery about money. The common man can decide the question correctly. One way to get his verdict is to ask him questions such as the following:

1. Do you think that one person or a few can become prosperous by letting them counterfeit money? (To this the correct answer is, *yes*, because such person or persons will be able to get a bigger share of the products produced, by buying with their counterfeit money. Other buyers must produce goods or services before they can buy; counterfeiters buy without being obliged first to produce or serve. They benefit because they are in reality thieves.)

2. Should counterfeiters be prohibited from counterfeiting and punished for it. (The proper answer is, *yes*.)

3. Do counterfeiters benefit society by counterfeiting, that is, by manufacturing money? (The answer must be, *no*; because exactly as much as the counterfeiter benefits himself, he hurts others.)

4. Is all issuance of manufactured money then to be condemned? (The proper answer must be, *yes*.)

5. Is circulation credit manufactured money? (The answer is, *yes*.)

6. Should additional circulation credit then be forbidden? (The logical answer, on the premises, must be, *yes*.)

7. Why then is circulation credit considered a big blessing for society, and why is it the chief foundation for some people's hope of general prosperity? (The answer is that such people do not understand what circulation credit really is; that they do not realize that circulation credit is the same as counterfeit bills; that they erroneously believe that circulation credit must be all right because the law allows it; and because the people who are given the privilege are the most distinguished and respected people in the community.)

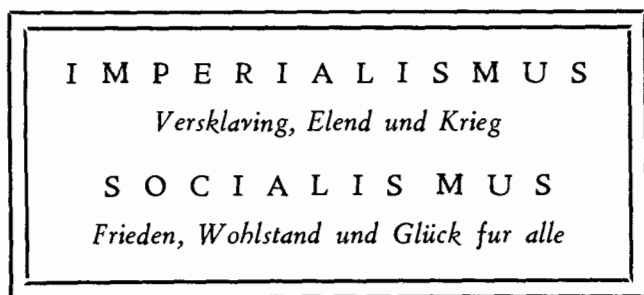
Favoring circulation credit involves bad logic, bad economics, and bad ethics. Even the "common man" should be able to understand that and vote that way, unless he is unable to understand that counterfeit money is bad.

8. If counterfeit money is bad and must be withdrawn as soon as possible, and if circulation credit is equally bad for the same reason, should it not be withdrawn as soon as possible? (To this the *logical* answer would be *yes*, but there is a difference. There is never much counterfeit money outstanding, and eliminating it will have no grave consequences; but there is *so much* circulation credit outstanding that removing it from the money structure would have tremendous consequences, in the form of deflating prices. Because prices are not properly "flexible," especially wages, grave consequences would follow. The best thing in this case is to stop *any increase* in circulation credit. (See August 1959 issue, pages 248ff.) This subject needs more extensive consideration.

## The False Claims Of Communists

(How They Dispute Walter Lippmann's Claims)

In East Berlin a huge placard, at the Marx-Engels Platz in connection with an industrial fair in the fall of 1959, carried the following:



Translated, this means:

### IMPERIALISM

Enslavement, misery (poverty) and war

### SOCIALISM

Peace, well-being and prosperity for all

*Imperialism* is here substituted by the East Germans for *Capitalism*. By such substitution, the idea is fostered that capitalism is to be identified with imperialism; that, however, needs to be proved, as well as implied or asserted.

The poster asserts in regard to capitalism or imperialism, that the people who live in a capitalistic system suffer enslavement, misery or poverty, and that capitalism is aggressive and a promoter of war. Contrarily, the poster alleges that socialism is the source of peace, well-being, and happiness for all.

Experience reveals that the foregoing allegations are false. Capitalism does not enslave, cause poverty, nor is it aggressive or bellicose. Nor is socialism peaceful, prosperous nor a promoter of happiness. If true, why is there only a trickle of people from capitalistic to socialistic countries, but a steady stream from socialistic to capitalistic countries? That stream away from socialism to capitalism would assume flood proportions if all hindrances to migration from socialism to capitalism were removed. *Migration* tells the story.

The East Berlin statements are propaganda and not truth.



Walter Lippmann has published a book, *The Good Society*. In it he alleged that socialist societies always are or always become *poor, oppressive, and bellicose!* and vice versa, that capitalist societies always are or become *rich, free and peaceful*. One is inclined to think that the communists in East Berlin had read what Lippmann wrote, were unhappy about it, and had decided that the best thing to do is to allege, in big type in big posters, just the opposite.

## "Rule of Law" As Customarily Understood Is Inadequate To Protect Society

Three of the requisites to human welfare and prosperity are (1) freedom, (2) the rule of law, and (3) the Law of God.

1. *Freedom*. The majority of men in the western world are in favor of freedom. But that freedom alone cannot be the whole program for a society — that, and no more.

2. *The Rule Of Law*. Awareness that freedom alone is inadequate has induced men to add a second requirement, namely, that to avoid anarchy there must be the "rule of law."

Law is a qualifier of freedom and impinges on it. The problem is *what amount and kind of law is advantageous?* To what question the answer of some has been: the law must be *universal*. *Everybody* must be *under the law*, the ruler as well as the ruled; the judge as well as the citizen; the wise and foolish; the strong and weak; the majority as well as the minority; the stranger and the citizen. There is to be *no* exception.

Why this *universality*? The reasoning underlying this is that if *all* men are under the law, and if the law is bad, then the law will be corrected, because nobody — not even the rulers — will tolerate a bad law when they themselves suffer under it. The hoped-for "protection" against bad law in this situation is the universality of current unpleasant experience under it. The expectation especially is that future experience will test the law to reveal whether it is good or bad. The idea of "rule of law" is, therefore, radically empirical. It does not consider that the basic principles of what is right and what is wrong have really been settled. It says instead: take a chance on the content of the laws you pass, but submit them to the test of acceptability to all. If generally accepted, the content of the law must be good; if not accepted, the content of the law must be bad.

3. *The Law Of God.* The combination of freedom and rule of law, as just defined, is inadequate, in our estimation. To these two we add a third requirement — the moral law of the Hebrew-Christian religion. At this late stage in the history of men, it is absurd, we believe, to protect men only by the empirical operation of the rule of law as in number (2), and to rest the matter there.

Is it debatable that *coercion* of men is evil? or *adultery*? or *theft*? or *fraud*? Is the protection that men are to have to come only from the universality of renewed current empirical trial and error, of any new law, which maybe obviously violates the prohibitions against coercion, adultery, theft and fraud? If the answer is yes, then it appears to us to be folly. What society needs is:

a. freedom — all kinds of freedom, except no freedom to do wrong;

b. a "rule of law" — all laws should be *universal*. Everyone should be under the law; and

c. The Law of God (the decalogue) — which needs no renewed empirical testing. The centuries have tested it and it is wasteful to re-test it; *no law should be tried, not even universally, if it obviously conflicts with the Law of God.*

Items (1) and (2) constitute Liberalism. Items (1), (2) and (3) constitute Christian morality. FIRST PRINCIPLES IN MORALITY AND ECONOMICS is more than Liberal; it is Christian.

\* \* \*

For example, no experimentation with *circulation credit* should be attempted if the issuance of circulation credit involves theft, no matter how subtle the theft may be.

## A Genuinely Liberal School System

When the question is asked, Who is responsible for the education of children, then the answers vary. The most popular answer is that the State is responsible. The second most popular answer is that the Church is responsible. Another answer which ought to be considered, but which is less frequently heard, is that the Parents are responsible.

In this country the State school system is known as *public* schools; the Church school system is known as *parochial* schools; and a Parent-controlled system, as *private* schools.

In regard to which system to favor, our answer would be: "Every man to his own taste."

\* \* \*

In his youth the writer worked for a distinguished business man who came as close to "perfect soundness of judgment" as almost any man can come. This employer came to work one day in a bad frame of mind. He had two daughters in their early teens going to a public grade school. There was something at the school which displeased him, and he kept muttering to himself, "These are *my* daughters; *I* am their father; *I* am the one who is responsible for them; and *I* am determined to have my daughters guided the way *I* want them guided."

This man by his words indicated that he held the idea that he had more responsibility in regard to the education of his children than the state had. (He avowed no religion, and consequently was not taking a parochial school into consideration.)

Probably if most people will give thought to the three alternatives to the question, who has primary responsibility for education — state, church or parents — then most of them will probably answer, the parents. If they give that answer, then the educational system which they should prefer is one consisting of private schools organized by parents. People who give such an answer, if they are genuinely consistent, should not rely (primarily) on the state-controlled public school system.

\* \* \*

To say that the parents have the primary responsibility for the education of their children is not to declare that the church has no valid interest in education or that the state should not concern itself with education. Almost certainly education is more extensive today in the United States than it would be if the state had not concerned itself in the form of raising money for education, and by insisting on school attendance up to certain ages.

To acknowledge the role that the state has played is not necessarily to admit that the influence of the state has all been for good. Probably the least doubtful of the acts of the state in regard to education is the requirement of compulsory attendance of children who are born into homes where there is indifference to education. Not everybody subscribes to the wise statement of Erasmus, the famous humanist, who declared that "ennoblement by

education is better than ennoblement by birth." In a sense, *compulsory* education endeavors to compel "ennoblement."

\* \* \*

The legitimate interest of the church in regard to education of the young will be obvious even on scant reflection. Faith can be defined as the "art of believing things regarding which the evidence is disputed."

For the biggest questions in life and in death, there are no *conclusive* answers. The origin of the world is shrouded in the unknown. We do not understand *fully* most of the things in this life. The evidence for the existence of a life after death is disputed. When knowledge of rather obvious things are taught in schools, they cannot be abstracted from, nor isolated from, the ultimate questions on the origin of everything, the nature of things, and the ultimate destiny of the universe.

If religion is defined as the answer (or the refusal to answer questions) about the unknown, then *everybody has a religion*. There is no such thing as a neutral position in education to which all men should be complacently willing to conform. Agnosticism is as much a religion as Christianity or Mohammedanism. Atheism deals as much in the unknown as does Christianity.

Every parent has, of course, a legitimate interest in the character of the instruction given to his children about these ultimate unknowns. Anyone who denies to religious folk the freedom to teach their children of tender age what they wish taught to them is as unjust as a religious person is who insists that his religion must be taught to the children of the first-mentioned.

There are, therefore, powerful reasons for churches assisting in the organization of schools along the lines of faith, that is, along the lines of their answers to the questions in life for which the evidence is differently interpreted by different people.

The big advantage of parochial schools is that their teachings in matters of faith are *stabilized* by about as much as the doctrines of the church itself are stable, and as much as membership is limited to those who adhere to those doctrines. In the protestant churches doctrines are rather unstable. In the Catholic church they are more stable, which gives a peculiar significance to the education in Catholic schools. Any religion hoping to survive for a long time must be slow to change, (but maybe not too slow).

The great advantage which parochial schools have over private religious schools is their potential stability.

\* \* \*

Segregation is one of the fundamental principles of life. Segregation is merely an unfelicitous way of expressing a fundamentally unchallengeable idea, namely, the individual *right to associate* with whom he pleases. It is especially since the rise of socialism-communism that the *right of association* has been challenged.

The right of association has been so universally accepted in the past that it was hardly felt necessary to formulate a doctrine in regard to that right. The cruel have ever tended to band with others who are cruel; the wise have sought the company of others who are wise; the pleasure-loving have sought the company of others who are pleasure-loving; the meek have sought the company of the meek; the virtuous have sought the company of the virtuous; spendthrifts are not the best of friends with thrifty people; the aged visit the aged and not the young; the religious seek the company of those who have the same religious convictions. The right of these to associate in this manner has never been disputed seriously.

Fortunately, this general right of association has never really been challenged (except recently when unfortunately it has been especially challenged in the field of education).

\* \* \*

If the question is asked, What is the *liberal* view in regard to an educational system (with *liberal* defined as a voluntary system), then the answer is that it is a type of system in which everyone has an equal right of association, without a penalty being attached to that in order to discourage selective association. If some parents wish to give their children a religious education, they should be under no greater burden to do that than any other group of parents. Similarly, if a certain race wishes to give a certain kind of education to its children, then it too should be relieved of any greater burden than other parents in regard to the education of their children. To be *liberal* means to let everyone have his maximum freedom.

If the state undertakes to collect taxes for educational purposes, it ought to be prepared to pay out those taxes to groups of parents who wish to have a school for their children. Let us assume that the state collects \$400 a year for educational purposes

per child. Let us assume that there are parents who have 50 children of school age. Let us also assume that they are peculiar folk who wish to have their children educated in a peculiar way. They ought to be entitled to a subsidy for their school in the amount of 50 pupils times \$400, or \$20,000.

Some people might say, and they may be right, that if there are only 20 pupils involved that the parents should be authorized to obtain a subsidy in proportion to that number.

*Liberalism*, with its general emphasis on liberty, has taken various courses. In England, for example, liberalism took the road of *free enterprise*. In the Netherlands, contrarily, liberalism took the road of *free education*. In the Netherlands, in a peculiar way, the emphasis has been on parents being permitted to organize their own schools, and to obtain a per capita subsidy from taxes raised by the state from everybody. Probably the finest flower of liberalism, in the field of education, has been in the Netherlands.

\* \* \*

If the question is asked, What would be a liberal system of education where the races are involved, then the answer should be obvious. The underlying principle should be that each parent can make his decision in regard to educational problems pertaining to racial questions, *without his being compelled by others to do what he does not wish*. That, after all, is the definition of liberalism — no compulsion.

The question is, How can compulsion be avoided on race questions involving schools?

There are three possible alternatives and no parent should be robbed of his choice of the three. The reason why no more than three choices should be offered is because no more than three *can* exist. The three choices are the following: (1) all-white schools; (2) all-colored schools; (3) combination white-and-colored schools.

In fairness to everybody concerned, if liberal principles are to prevail where a community is racially mixed, those three kinds of schools should be made available. If only any two of these kinds of schools be made available, the system is not liberal. For example, if only white and colored schools are available, then parents who wish their children to go to a mixed school cannot follow their option; they will be under compulsion to send their children to an all-white or an all-colored school.

If, for example, the two schools made available are a white school and a mixed school, then those who want an all-colored school are denied their rights. If only a mixed school and a colored school are available, then those who wish a white school are denied their rights.

Whenever a Supreme Court limits its decision to the existence of only two kinds of schools, an all-white school or an all-colored school and when its decision does not point the way to the only real solution of the problem, namely, to a system which avoids compulsion of anybody, then by having had its attention fixated on only two systems, it has failed to find the right solution because the right solution is dependent, in this case, upon a three-phase system.

\* \* \*

To be liberal, the school system in the United States must be highly varied. There should be public schools, parochial schools and parental (private) schools. There should be art schools, science schools, trade schools. There ought to be religious schools, agnostic schools, atheistic schools. There ought to be white schools, colored schools, and mixed colored and white schools. Everyone of these schools ought to be in competition with every other school, whenever they cover the same fields. Competition is a salutary factor in life generally.

If the government is going to continue to collect taxes for educational purposes, it ought to pay out an average amount per pupil to each of these schools as a subsidy. If any particular school wishes to spend more than average, then the folk operating that school should dig into their own pockets.

\* \* \*

The distinguished magazine, *FREEDOM FIRST*, published in Great Britain by the Society for Individual Freedom, recently contained a remarkable article on education by the head master of an English school. One of the points which he made was that *the pupil in a school learns more from the pupils than from the teachers*. He made the further point that parents "sense" that, and consequently that (especially in good families) schools are selected with the greatest care, and that as much attention is given to the kind of homes from which the students come as is given to the teaching staff. Such being the case — that children learn as much from their associates as from their teachers — the right of

association exercised by responsible parents is a primary right. Any denial of it temporarily by governments or courts will result in evasion, hatred, disloyalty and maybe the ultimate destruction of the government.

\* \* \*

While abroad recently the writer overheard two educators talk about their educational problems. One of them came from a community disturbed by segregation questions. He was telling his colleague about the vicissitudes through which they had passed during the school season 1958-59. Those vicissitudes were discouraging and some might even call them alarming or appalling; no building, no equipment, etc. — everything improvised.

His colleague finally, commiserating with him, expressed his regret at the great penalty suffered by the poor children under those circumstances, and the damage to their education. But the rejoinder of the first man was instantaneous: "Oh, the children learned more last year than in any year. All the frills had to be abandoned. The result was that they were better educated last year than ever before."

It is not expensive buildings nor elaborate equipment, nor government support — none of these things — which make good schools. Such circumstances may be helpful; but they may also be harmful.

#### A Reader's Supplementary Syllogism

We have received the following from a distinguished reader:

Enjoyed your December, "*First Principles*" very much, notably your syllogisms. In connection with your sentence, "It is a form of irrationalism," I submit the following *clincher* syllogism:

*Major Premise:* To "discriminate" or reward promotes personal well-being and social health and harmony.

*Minor Premise:* To each according to his merit is to "discriminate" or reward.

*Conclusion:* Therefore to each according to his merit promotes personal well-being and social health and harmony.

—Adolph O. Baumann

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## "Religion And Culture" — AND ECONOMICS

In 1959 a book containing "Essays in Honor of Paul Tillich" was published under the title, *Religion and Culture*; it was edited by Walter Leibrecht, and the publishers are Harper & Brothers, New York.

One of the essays in this book, by Reinhold Niebuhr, entitled "Biblical Faith and Socialism: A Critical Appraisal," is the occasion for the endeavor in this issue to show in perspective the position of present-day Protestant thought.

Niebuhr is maybe the most-brilliant, living Protestant theologian, and what he writes obtains an international hearing, because of his prominence in thought leadership in the World Council of Churches.

In contrast to the title of the book selected by Leibrecht, the title of this introductory article in this issue is: "Religion and Culture" — AND ECONOMICS. Our addition, "And Economics," is deliberately selected to reveal our specially selected "viewpoint," our perspective, the starting point of our critique of the thinking not only of Tillich, but also of Niebuhr and the other most prominent theologians who are the spokesmen and leaders of Protestantism today. We seek to promote the idea of adding and relating economics to religion and culture. However prominent Protestant theologians may be in the fields of

religion and culture, they occupy positions of small consequence in the field of economics.

\* \* \*

Economics may be viewed as a *technical* science pertaining to money, markets, labor, production, distribution, foreign exchange, natural resources, that is, *material* things and external objects. Protestant theologians have not demonstrated that they are vitally concerned with technical economic subjects. There is some reasonableness in theologians not being technical experts in the field of economics in that sense.

But economics may be viewed in a broader way, namely, as pertaining to the *relationships* of men to things, and consequently as pertaining to the relationships of men to men in so far as this latter relationship is affected by the relationship of men to things.

Further, *things* here do not refer to material things only, but all that men seek for, and for which they put forth effort — things of an intellectual, religious, artistic, charitable, or entertaining, as well as physical, character.

Men do not live in a vacuum; they live in an environment, a cosmological structure of which they are a part. It is not to be denied that that environment, or grand aggregate of circumstances which makes up the cosmological structure of life, is important when appraising the conduct of men within that cosmology.

We might define economics then as the science of the *relationship of men to goods* — with *goods* including everything that men *value* (physical or spiritual).

And what do men *value*? Whatever they believe they need, but which is *scarcer than their needs*. Nobody feels a need for fresh air out in the great outdoors. Wherever supply exceeds the demand, that thing of which the supply is greater than the demand is a mere *thing* in economics, not a *good*. In economics, then, a *good* is something regarding which *by definition* there is *scarcity* as well as *need*.

Immediately, that fact of scarcity relates economics to ethics. If there is a *scarcity*, there will be a problem of *justice*, a method

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being needed to decide who is going to participate in the limited supply which is inadequate for the aggregate demand. When economics concentrates on questions pertaining to "goods," it works on questions which must involve throwing light on problems which theologians and moralists undertake to appraise as right or wrong.

Is it not a significant omission for theologians to neglect to learn what a *science* alleges it has to say as description of the character of the relations of men to goods, and on how to *maximize* the satisfaction that men may obtain from goods?

The title to this article, "Religion and Culture" — AND ECONOMICS was selected not only to reveal the viewpoint of the critique which follows, but also to register an earnest plea that theologians should undertake the study of economics. A theological faculty can hardly consider its curriculum to be complete without courses which will offer its students a mastery of economics. To teach ethics without economics is to teach what men owe to each other *in abstracto*, without adequately considering men's environment, the cosmology, in which they live.

When Einstein "reconstructed" physics, he directed attention to the "frame of reference" in which an event takes place. An event is not understandable nor accurately describable except when the "frame of reference" is clearly designated; for example, a man sitting motionless in a moving train is not moving *relative* to the train, but he is moving *relative* to the countryside; the countryside in turn is moving *relative* to the center of the earth; further, the earth is moving *relative* to the sun; and the sun is moving *relative* to something else. What then is the movement of the man in the moving train *except in relation to a specified "frame of reference"*? And so *relationships* — relativity — become determinative. In economics the frame of reference for the relationship of men to men is the relationship of men to things.

The editor of *Religion and Culture*, Prof. Walter Leibrecht, selected as his partial "frame of reference," *Culture*, but that is not a wholly comprehensive frame of reference. He might have chosen for his title *Religion and Culture — And Justice*, but *justice* would hardly have been an adequate term, because for men as Niebuhr and John C. Bennett justice would really mean *charity* or even more accurately, *alms*, because the "justice" of their systems is wholly dependent on what is, in essence regardless

of what it is called, alms. An endeavor to select an adequate ethical frame of reference based on *charity* is doomed to giving such a distorted understanding of human life that the consequences will be damaging rather than helpful.

\*       \*

In what follows, we look at Religion not only in the framework of culture, but also in the framework of economics — the framework of the relationship of *men to things*, operating in a *free* market. Any frame of reference pertaining to the relationship of men to things which is really a frame of alms, rather than of mutual benefit from exchange, is not an adequate framework.

Consideration is given in the next article to the four Protestant theologians who may be appraised as being the most influential at this time.

### The Four Most-Influential Living Protestant Theologians

The four men here being nominated as being the world's most-influential, living Protestant theologians are (1) Reinhold Niebuhr of the United States; (2) Karl Barth of Switzerland, (3) Paul Tillich, formerly of Germany but now in the United States, and (4) Anders Nygren of Sweden. There may be a better list; but this is a list for the special purposes of this issue.

These are the theologians whose books are most widely read; who are the leaders of the "intellectuals" in the religious world; who are the spokesmen; who are the men who have been most influential in recent years in coloring the thought of those who (allegedly) speak for the Protestant public on questions of ethics, politics and economics.

There are, of course, other distinguished Protestant theologians, who are without peer in fields of theology which are outside the fields here being considered, namely, ethics, politics and economics.

\*       \*

Reinhold Niebuhr was named first. By his writing, his speaking, and by his influence on men in positions of leadership in the World Council of Churches, Niebuhr probably outranks other living Protestant theologians in his influence in the fields of social action, politics, and economics.

Niebuhr is a *this-worldly* theologian. Whatever the Kingdom of God may be in a *future life*, Niebuhr appears to be primarily interested in a comfortable Kingdom of God in *this life*; that explains his concentration on ethical, political, social and economical questions.

No other theologian has manifested equal ability in caustic criticism of the naivete of others, whether orthodox or modernist.

Niebuhr is an independent thinker, who has continued in his full maturity to give evidence of capability of re-reviewing the evidence, and changing his mind.

\* \* \*

Karl Barth is second on the list. In various respects his influence exceeds Niebuhr's. In Europe, Barth *dominates* Protestant *theological* thought.

Niebuhr is hardly appreciative of one aspect of Barth's thought. In Niebuhr's essay in *Religion and Culture*, which will be considered later, he has this to say of Barth (referring to Barth's interest in eschatological problems, that is, problems pertaining to a *future life*) (our italics):

. . . Barthianism, initiated by an ex-socialist and *pretending* to have achieved a sublime transcendence over the vicissitudes of history and a *ludicrous irresponsibility* toward the ordinary tasks of the political community . . . [has fallen] off one side . . . of the tight rope of eschatological tension which is at the heart of the relation of the Christian faith to the social scene.

Apparently in Niebuhr's view Barthianism is devoting too much attention to utopianism in regard to a *future life*, the *future* Kingdom of God, and to other subjects.

Niebuhr seems to have become only secondarily interested in utopianism concerning a future life, that is, the salvation that Christians expect after death. He has confessed the error of some utopianism of his own (utopianism for *this life*), but in order to differentiate his own view from that of the most-famous, European Protestant theologian (Karl Barth) Niebuhr reveals what he thinks by the ear-piercing words, "pretending to have achieved" and "ludicrous irresponsibility." We concur with Niebuhr as far as he goes.

Rejection of Barthianism should go further. Not only is its irresponsibility somewhat ludicrous, its essential structure of thought is unacceptable in a modern world. Intellectually it is a retreat to medieval times. Barthianism is unhinged from modern

science. It concerns itself with long discussions about the unknowable; it is hardly rational speculation; it is fantasy in the name of religion and neo-orthodoxy.

Barthianism is in a sense a throwback to medieval scholasticism. The scheme of thought which Barth presents is not different in kind from that which prevailed *before* William of Occam (or Ockham). Occam, (1270-1349), an English Franciscan friar, struck the death blow to the "thought" of the Middle Ages. He basically attacked its logomachy ("disputes about words, controversies turning on mere verbal points") and by doing that he destroyed scholasticism's prestige, its fun and its existence.

To usher in the modern age two things were necessary, the logomachy of scholasticism and philosophy needed to be discredited; Occam did that. In addition, a substitute method for enlarging thought needed to be provided; Francis Bacon did that, by his empirical, inductive approach.

Barth belongs in the centuries between 900 and 1300. His proper title might be, Professor of Modern Logomachy.

\* \* \*

Nygren, least known (outside of theological circles) of the four most-influential Protestant theologians living today, has concentrated his efforts on an exegetical problem, namely, what are the Biblical teachings regarding each man's duty toward his neighbor.

When Nygren answered that question he probably intended to do Christianity a service, but he did it a disservice. In an argument — if you wish to win it by foul means as well as fair — you endeavor to "extend" your opponent's position; you first restate his case by *exaggerating* his proposition. Then you argue against the exaggeration which you have perpetrated. The ancient Romans had a name for this fallacy, or this deliberate trick to over-bear an opponent in an argument, viz., *ignoratio elenchi*.

As everybody knows, the "broader" on allegation is, the harder it is to defend; contrarily, the "narrower" a proposition is, the easier it is to defend. Nygren, not to hurt Christianity but to help it, has blundered into "extending" the Biblical doctrine of neighborly love into the most extreme requirement yet advanced with any seriousness in the history of mankind. We must, he says if we are to heed Scripture, "love" our neighbor "without motiva-

tion," that is, without giving any consideration to his merit or demerit — we must love the bad man as well as the good — *equally*. Only then is our love, our *agape* (one of the Greek words for *love*) adequate and Biblical.

Socialism demands *egalitarianism* in remuneration. That is almost a trifle compared with Nygren's requirement (in the name of the Christian religion) to be egalitarian in our love for an evil man so that it matches our love for a good man.

Nygren is the man who has the distinction of "discovering" a definition for love (*agape*), which provides an ethical base for the famous principle of communism, From each according to his ability to each according to his need; and further, that discrimination according to merit departs intrinsically from Christian ethics, because discrimination itself violates the requirements of true *agape*, genuine brotherly love.

\* \* \*

Paul Tillich, the fourth theologian on the list, is not a Christian theologian in a historical sense. His "field" is not what the specific words of Scripture teach. He works primarily on what might be called the philosophical front of theology. He does not pore over Biblical texts in a traditional manner.

The framework of thought, existing at the times that the various authors of the parts of Scripture wrote, has been made irrelevant for modern man by the findings of science. Bare Scripture is no longer relevant unless it is interpreted in wholly modern fashion. And what might religion be? It is an "ultimate concern" regarding the origin, nature and destiny of man and his environment. Who does not have "ultimate concern" about such questions lacks a religious character. But if we have "ultimate concern," more or less, regardless what our conclusion may be, then we are responding to our religious capabilities.

Tillich, in effect, defines religion as an awareness of the existence of problems rather than specific answers to problems. He is an existentialist, endeavoring to find the outlines of a *modern* religion, rather than a believer proclaiming the traditional answer to the problem which an orthodox Christian gives.

Tillich, too, has looked to socialism to save the present world. After World War I he was one of the organizers in Germany of so-called "Religious Socialism."

\* \* \*

All these men have characteristics in common.

In the first place, they give evidence of being inadequately informed on economics; their writings give evidence of lack of real understanding of the cosmology in which men find themselves.

Secondly, they all have, or have had, an over-simplified, "almsy" solution to the problems of this life, namely, the solution of socialism, that is, extensive redistribution of income and property in the name of "justice" or "brotherly love."

Niebuhr describes Barth as an "ex-socialist" and Barth's unwillingness to be severely critical of Communism is well-known. Tillich was the real founder of the Religious Socialists. Niebuhr himself reveals his own partial disillusionment (in the essay to be reviewed) with Christian socialism; he admits that his former hope for a Kingdom of God in this life rested on the premises of what he considered to be *Christian* socialism. Nygren, wittingly or unwittingly, has "established" the essential link between (alleged) Christian ethics and the main thesis of socialism; beyond that his political and economic persuasion is not known to the writer.

These most-influential leaders, then, of modern Protestantism more or less identify Christian ethics with the program of Marxian socialism. These Protestant leaders in the world today think — or have thought — in a framework that equates practical Christianity in this life, their Kingdom of God, with some form or other of socialism.

Niebuhr, making observations with intellectual honesty, has noted that the socialist solution has defects, and so, several years ago, he wrote that he was not to be held accountable for what he had written in the past on social questions. That is probably why he used the word *critical*, in his current essay, "Biblical Faith and Socialism: a *Critical Appraisal*" (our italics).

\* \* \*

1. In what follows, it is proposed first to approach the problem of religion in the philosophical way in which Tillich approaches it. The first following article is in Tillichian vein — but Tillich is not to be held accountable for it in the remotest sense. It is entitled: "That Inchoate Proposition of the Pantheists — Dust is God."

2. Next, it is proposed to make an approach *a la* Niebuhr to the Creation Narrative. Niebuhr rejects the historicity of the Crea-



tion Narrative, but accepts what he believes it symbolizes. (It is not unusual for Niebuhr to disparage the form in which Scripture presents its teachings, but he is a doughty, *indirect* defender of Scripture in the form of strongly promoting what he declares to be the essential teaching of the scriptural incident.) The interpretation here given of the Garden of Eden narrative will be Niebuhr-ian in style, but Niebuhr will not in any sense be responsible for it, nor will this interpretation have sympathetic relationship to the content of Niebuhr's ideas on the subject. The title is: "A View of the Cosmology of the Garden of Eden."

3. Next, there will be comment on Niebuhr's Essay, "Biblical Faith and Socialism: A Critical Appraisal," under the title, "Niebuhr's Disillusionment with Socialism, and His New Solution to Social Problems." The essence of Niebuhr's position now seems to be: (1) he knows that he has been somewhat in error about Marxian socialism (unduly utopian in his confidence in the Marxian proposals); and (2) he has no new *principle* for solving public ethical problems, but he is relying on compromise and empiricism. What he really needs is a genuinely new principle, which, we believe, he has not yet found.

4. Finally, it is intended to outline a course which, if followed, will revolutionize — for good — the thinking of Protestant theologians on social, political and economic questions. They will then not only withdraw from the wrong track on which they have been floundering; and they will not stagnate in the pools of compromise and empiricism; but they will find a better road, and recover a simple and genuine understanding of Hebrew-Christian thought. There will be a brief article on this subject under the title, "Finding One's Way in the Labyrinth of Economics."

## That Inchoate Proposition Of The Pantheists, "Dust Is God"

*Faith* is the acceptance of a nondemonstrable solution of a problem, for which the capabilities of the human mind apparently are insufficient to supply a truly explanatory analysis.

The origin, character and destiny of the phenomena of the world are not *surely* known by any human being. The choice therefore, when trying to find an answer, is either (1) to select one of the several answers given by faith, or (2) to reject or ignore the

problem. To ignore the problem is to down-grade the self to the level of animals. Cattle do not concern themselves about their origin, nature or destiny. A man who does not is in that respect not wholly different from a cow.

The men whom the rest of mankind think have lived and thought most admirably include those who have really endeavored to answer as well as they could the riddle of the origin, nature and destiny of men and of the world. These wise men have, in a broad way, held to one of three faiths: pantheism, agnosticism, or theism.

The *pantheist's* solution is that there is no *transcendent* god, that there is nothing behind or superior to the phenomena of the world. According to this view, there is nothing outside of what we can observe to explain what we observe. The explanation must be in the thing itself.

The *agnostic's* solution is that there is no explanation to the mystery of the universe that is really acceptable. This attitude does not differ *in principle* from a bovine indifference to the problem. The agnostic deliberately and consciously rejects attempted affirmative solutions to the problem. Whereas cattle *ignore* the existence of the problem, the agnostic *abandons attempts to solve* it.

The *theist* rejects the pantheist's proposition that the world is its own explanation and that there is nothing outside of it; he also rejects the negativism of agnosticism as a form of irrationality; instead he proposes the answer that a supreme Intelligence, transcendent, but in, above and around the world, is the real explanation. That *transcendent* being the theist calls God. God made all things, controls all things, and will determine the destiny of the world.

The pantheist's ideas cannot be proved; pantheism is a faith. The agnostic's ideas cannot be proved; agnosticism is a faith. The theist's ideas cannot be proved; theism is a faith.

When the theists attempt to define or describe their God, they become disunited and fly off in different tangents all along an arc of  $360^{\circ}$ .

The theists who have developed the most-complete, the most-accepted, and most-acceptable system are the Christians. They believe in a Supreme Being who is all powerful, all wise, all merciful and the "overflowing fountain of good." They declare that they possess that concept of God by *special revelation*, and not by human logic.

Because of the assertiveness and confidence of the adherents of the Christian faith, and because of their claim that any other hypothesis of the unknown origin and destiny of the world is false and foolish, the word, *faith*, has become attached, almost exclusively, to the Christian religion. The reality is, however, that those who differ from the Christian religion have their own faiths, whether that is another brand of theism, or is agnosticism, or is pantheism.

IN FIRST PRINCIPLES OF MORALITY AND ECONOMICS we are theists of the Christian persuasion.

\* \* \*

The real antonym to theism is pantheism. Pantheism holds that the explanation of the world lies in itself, its materials, its laws, its phenomenology; god, in this case, is not transcendent but is no more than chemicals and life — a combination or something of dust, stones, plants, men. If there is a "god", he is immanent in the world, not transcendent. Because in this view of reality god is not transcendent, there is an irreconcilability with theism whose essential tenet is the transcendence of God.

Let us approach pantheism sympathetically. Its proposition is that the world explains itself. It has no transcendent cause. Its marvels in natural and social law are *within itself*.

The two great features of the world as we know it are its (1) material (dust and stones), and (2) life (living beings).

The relation between (1) the physical material of life and (2) life itself is that the latter apparently is dependent on the former. There is no earthly, observable *evidence* of life except in connection with some *material* base.

The glorious part of the world is the *living* part — plants, animals and men. The crown of all is *man*. He feels; he thinks; he has purpose; he can change his environment. He is at the apex of anything that the universe has produced. The "glory" of this pantheistic conception of the world is *man* himself.

Let us take the greatest among men. What happens to him? He dies. Let us visit the crematorium and look at the urn in which his ashes are. They give no sound; do not move; do not hear; see; smell; feel; taste. There is no purpose any more. And these inert particles of dust are all that is left of the genius; he was at the very top among men; and men are at the very top of all manifes-

tations of life; if pantheism is the "explanation" of the world, then it has let this best that it produces change to dust.

In a pantheistic system, if reality is more than dust, then that extra beyond mere dust is the phenomenon of *life*, that something which changes matter into something more than that which lacks life.

If the claim is that the dust in the cremator's urn is not the man that once was, then the difference must lie in the fact that *life* is no longer there. But what then is *life*? *That probably is the most fundamental problem for man to endeavor to solve.*

Is *life* just a process? And why is it so "wasteful"? Each generation begins helpless and ignorant. Strength and knowledge are hardly obtained before physical strength begins to fail.

Until the pantheist has explained what *life* is, and how it differs from the dust in the cremator's urn, it is reasonable to ask him, *is Dust your god?*

And what about the "natural laws," the observed regularity of events? Did Dust generate those natural laws? Did mere dust determine the laws that generate life and determine death?

The phenomenal world may appear to be a wonderful *unity*, but it is not. Today the genius is with us — alive, thinking and acting marvelously. But tomorrow he is dead. A quick and ghastly change takes place. The brainiest part of the universe has suddenly ceased to think. The fairest flower of the "material world" has suddenly become putrid and ugly.

\* \* \*

In a sense it is paradoxical to think that *life* is the best of the material world. To be alive involves to want — lack — something. To be alive means to have purpose. To have purpose means that what you do not have appears better to you than what you do have. To be alive is synonymous with not being satisfied. The dead have rest. The alive are restless. Why should we not all hunger for death in order to be at rest? If we are material which has life, would we not be better off as material without life?

Unless and until the pantheist has explained *life* — an explanation which appears not yet to have been given — he has presented no coherent picture of the universe. Until he has done that, his pantheism is equivalent to the proposition, DUST is GOD.

\* \* \*

The theist (Christian) solves his problem his way by declaring that there is a transcendent being, God, with a capital G.

The outstanding characteristic of that God, according to the Hebrew-Christian view, is His insistence on men living by certain rules, but this insistence is accompanied by an overshadowing mercifulness. The might and wisdom of God are paralleled — or overwhelmed — by his love.

Further, He will never be seen, because He is invisible. Not even in the life to come will God *himself*, according to the Christian religion, ever be seen by any man. Not ever expecting to see God himself, in his essence, the proof of God (even in a future life) will not be ascertainable. This must be the only correct view despite the expectation of seeing the second *person* in the Trinity in his *human nature*. In his *divine* nature the second person of the Trinity will continue as invisible and noncorporeal as are the other two persons in it. There is no "risk" about God in the Christian religion: neither its adherents nor any other creature will ever see the Invisible God. So the Christian religion teaches.

But in regard to the materialistic proposition, that Dust has the attributes of a god, it appears as difficult to accept as is the negativism of agnosticism, and it is certainly no better than the optimism of theism.

\* \* \*

Faith being the art of believing things for which there is inadequate evidence, therefore, everybody has a faith, except those who do not seek any solution to the origin, nature and destiny of their existence.

In a sense we are all either pantheists, or agnostics, or theists.

## A View Of The Cosmology Of The Garden Of Eden

In the Hebrew-Christian Scriptures everything pertaining to the origin, and all of the history, of the world up to four thousand years ago is covered in about 7,500 words, or twelve pages in a typical Bible. This early Biblical history is obviously radically abbreviated. The report of a small obscure association, for only one year of its existence, may be longer than the Biblical narrative of the origin of the world, and of man, and his early history.

The features of the story are worth pointing out: (1) a Supreme Being created the universe; (2) the lower forms of life came first; man is the peerless crown of creation; (3) his intelligence and his capacity for "good and evil" constituted the foundation of his superiority; (4) nevertheless, man was worse off at first than beasts because he had no fur to keep him warm; nor claws to tear animals apart; nor did he have tools of any kind; he was not even a stone-age man; (5) although he had the capacity to take the right road to boundless well-being in this life, he chose the wrong road, and his descendants after him follow in the same wrong road; (6) the consequence of taking the wrong road was to incur distress and the necessity of harder work, and consequently man has since suffered material privation as well as spiritual impoverishment (spiritual death).

Niebuhr takes this creation narrative symbolically. The events reported, he holds, did not happen that way, but certain truths about the nature of man are correctly symbolized by the story. We go further. We accept the cosmology presented: (1) a creator; (2) man at the apex of creation; (3) with an intelligence capable of knowing "good and evil"; (4) man's initially sorry economic plight; (5) that Adam adopted the wrong course and that his descendants do the same; (6) that the consequences were inexorable, spiritual destitution (death) and damaged temporal welfare.

For the present purpose, the following subjects will be discussed: (1) a difference between man and the lower orders of creation; (2) the wrong course which Adam took; (3) the essential nature of his sin—not a sin against altruism but against a law requiring cooperation; and (4) the inescapable consequences. (We have indicated earlier in this issue our acceptance of theism, and so the role of the creator does not need discussion; man's indubitable sorry economic plight before his fall is so clearly indicated in Scripture that it is not disputable; see Volume III, pages 266-297.)

#### **A Difference Between Man And The Lower Orders Of Creation**

Whatever has life seeks its own welfare. It is not inert, nor passive when unfavorable conditions arise. And what every living thing does for survival, it also does to attain joy of living,

pleasure, comfort, opportunity. This is true of plants, bugs, birds, rodents, insects, animals, men.

But the lower orders beneath man do not struggle to survive and to enjoy life *by means of cooperation*. Trees growing densely show no compassion to each other. Each tree is for itself *only* and it is either/or. *Either* the individual tree will survive *or* its fellows will. It is every tree for itself.

Animals will fight for their dependent young, but eventually every beast is "on his own." Animals do run in packs for defense purposes, and bees and other species live together in colonies; there is some division of labor in such communities. But the idea of *cooperation*, as man has the ability to understand it, is not known in the lower orders.

After man was created with his endowment of intelligence, there was a crucial decision for him to reach: would he act differently toward other human beings than other living beings act toward their own kind? Or would men, because they were rational, adopt a noteworthy system of genuine cooperation? The alternative would be that men would live as uncooperatively as cattle, wolves, rabbits, eagles, cats and dogs.

If a system of cooperation among human beings was to be attained, what specifications would it be obliged to have?

One solution of the problem might be that men would have a different (loftier) motivation than living beings of lower orders. Instead of *self-preservation* and *individual* welfare, men might instead have been constructed differently, namely, they might be *altruistic* rather than *selfish* (in the sense that they strove for self-preservation and personal welfare, not in the sense of nasty self-seeking *at the expense of others*). Then the chief concern of each man would have been the welfare of others rather than his own.

But men were not constructed that way. Their "construction," as far as being selfish versus altruistic is concerned, is identical to that of the lower orders. Men, beasts and plants are *primarily* motivated by self-preservation, personal welfare, individual happiness and subjective satisfactions. There is nothing really to be expected from the altruism of men. It is contrary to their *created* nature, before their Fall as well as after.

Altruism is not only unrealistic, it is also a *too high*—an

*unnecessarily high*—solution of the problem of how to obtain *cooperation* among human beings. A more modest requirement—if observed by men—would accomplish the desired result—and far better.

That more-modest requirement (or better, list of requirements) to obtain *cooperation* among men—rather than to have the strife—or at least lack of cooperation—common within the lower orders—consists of the following:

- (1) *no coercion* of one man by another.
- (2) *no deception* of one man by another.
- (3) *no theft* from one man by another of what the former has as his possession, not having gained it by violation of (1) and (2).

When mankind set out on its course (with Adam as its first exemplar) he had, shall we say, three choices:

- (1) Uninhibited *self-seeking*, as by plants and beasts below him; or
- (2) Lofty altruism, seeking the welfare of others rather than himself; or
- (3) Self-seeking, but firmly keeping it in bounds by rules against violence, deception and theft.

But there were, really, no three available choices for Adam. The first choice, uninhibited self-seeking, by definition, would have kept man in the class of the beasts and plants. The second choice is contrary to the nature of living things, and involves an absurdity—that the purpose of existence is not the self but other beings. (Altruism sounds lofty; but it is slavery to others.) The only real “choice” was the third, that is, to be self-seeking, but to avoid coercion by violence, by fraud, by deprivation of goods legitimately acquired.

The requirement for man was that although he remained self-seeking (by the law of life) he must put bounds to that self-seeking by avoiding coercion of his fellows. He would then, in principle, substitute a *contract* society for a *coercive* society. By a *contract* society is meant a society in which matters between men are settled by agreement, by compromise, by contract, rather than by force in the form of open violence, or “force” by deception, or “force” by deprivation of legitimate possessions. See



what Mises has written about a contractual society, in *Human Action*, pp. 196-199.

### The Wrong Course Which Adam Took

Any test in the Garden of Eden, if man was to have a supra-bestial society, would have to establish not whether Adam was to be an altruist, but whether he would deal with his fellows by contract, that is, by cooperation, rather than by coercion. The test would have to discover whether he would abstain from violence (murder or maiming) or deception (trickery, falsehood) or deprivation of property (theft).

*Violence* was for Adam in the Garden of Eden an improbable and, in fact, a self-defeating test. There were only two people present. A murder would have ended the race, and anyway they were mates. Adam undoubtedly found his wife so delightful to look at and to have around that he would not think of murdering nor maiming her under the circumstances.

*Falsehood* might have been the subject of the test in the Garden of Eden. It is indeed made part of the narrative of the Fall of Adam, but although not to be minimized, it is not the major item in the test.

According to the Genesis story the real test that was applied was one pertaining to *theft*. And the test was an easy one for Adam. He was told he might eat from *all* the trees of the Garden *except one*. According to the report, God retained his own claim on the fruit of that one tree. If Adam had observed the requirement God set in this case, he would have demonstrated that he was prepared not to trespass on the rights of another owner, but to respect them. He would have demonstrated that he was prepared to operate in a *contract society* rather than a *corecive society*. On test, Adam failed, as his descendants have systematically done after him.

Some have thought that the test had a sexual aspect. But a test of infidelity between Adam and Eve was hardly possible, there being only one man and one woman. (Adultery can be looked upon by an innocent mate as *theft* by a stranger of his or her mate. The law recognizes that aspect—that adultery is *theft* of a mate—when it permits collecting damages for alienation of affection.)

**The Essential Nature Of Adam's Sin —  
Not A Sin Against Altruism But  
Against Laws Requisite To Cooperation**

There is no hint in the test in the Garden of Eden that Adam was to demonstrate by the way he responded that he was expected to be an altruist. All that was required was that he honor the property rights claimed by God on the fruit of the Tree of the Knowledge of Good and Evil.

The tree could have had no magical characteristics in itself. It was instead a symbol of the good of knowing that the property rights of others needed to be respected; and it was a symbol of the evil of willfully violating the property rights possessed by others.

The test did not require that Adam sacrifice himself for another, which the test, if it were altruistic, would have required. The "sacrifice" by Adam of not eating from the particular tree was almost certainly a mere bagatelle, in the sense that Adam's position was not measurably worsened by not being authorized to eat the fruit of that *one* tree.

If Adam did not see fit to recognize the title to ownership that God reserved to Himself in regard to the Tree of the Knowledge of Good and Evil, he would have no sound reason for claiming any property rights for himself. If *A* does not recognize that *B* has property rights, then *B* is not likely to recognize property rights which *A* claims. Where will men then be?

(1) They will be acting like beasts who know no property rights in any real sense; or (2) there will be property rights, but they will rest only on strength and coercion; the strong will seize what is valuable; the weak will be exploited; society will be founded on *coercion* by the strong, and not on *contract* rights and obligations binding all men.

Why was abstaining from eating of the Tree of the Knowledge of Good and Evil, under the circumstances described in the Garden of Eden, an excellent test and symbol of what God was requiring of men, having endowed them with reason? It was such a test because: (1) it allowed unrestricted latitude to Adam to utilize every resource available to obtain food except that to which someone had a prior title; (2) his incentives were not restricted; he could work wholly for himself; self-interest was not sin, and, because personal incentive was left untrammelled,

great achievement was fostered; the prospects were that, under the spur of a natural incentive, he (Adam) would try to improve his circumstances; but (3) the restraint on his incentive consisted only in not letting him exploit another by seizing what belonged to another.

Self-interest plus the restraints of the Law of God—that combination—is superior to altruism. The advantage of the combination is that it stimulates great effort, without damage to others. Altruism contrarily lacks (under the law of creation) any real spur of incentive. The combination, self-interest plus the Law of God, constitutes the equivalent of a powerful engine and good brakes. Altruism lacks a good engine. Because it lacks a good engine, brakes are rather superfluous.

#### The Inescapable Consequences

When put on test, Adam failed. What were the consequences?

In the first place, he impaired his lot in life in a physical sense. Life was going to be harder on him and his descendants when they failed to recognize property rights, or more broadly, when they elected to rely on coercing neighbors rather than by living by contract—by mutual agreement. Remember Ricardo's Law of Association.

In the second place, Adam betrayed his own superior human nature, destined for a contract society, and consequently he incurred a terrible spiritual impoverishment—or in the language of Scripture—his soul underwent spiritual death. He missed his mark; he sinned; what happened to him was what he had been warned against—"the *day* thou eatest thereof *thou shalt surely die*."

That expression has been generally understood to mean physical death, or else physical death as well as spiritual death. But the text cannot refer to *physical* death, because, according to the record, Adam did *not* die physically that day. But that was exactly the warning; "the *day* thou eatest . . ."

*Death* should be considered a *normal* phenomena in the universe; in other words, *physical* death, when a being is in full maturity of its years, is not essentially a punishment for sin.

The cosmology of the world is based on one order of life serving another order. Cows eat grass, killing it by eating it. Birds survive by eating bugs or seed, killing life in either. Cats

in turn eat birds. Death is an obvious part of the cosmology of the sub-human world.

The plan of creation depends on generation after generation—birth, growth, maturity, decline, death—at best. The full sequence often fails. Is it not absurd to believe that there is a relationship between the death of an old, worn-out cow and the sins of men? An old cow dies because she was so created that she would in due time die.

The same thing holds true of mankind. It is normal, *creational* phenomena that men grow old and die. Such physical death is not the consequence of sin, although sin will have hastened it. Ultimately, the physical death of man is based on the biological laws which God established.

That is not the popular doctrine. But even in orthodox churches, as in the obscure and obscurantist denomination to which the writer belongs, doctrines have been approved which represent that view. For example, in this denomination, a view is tolerated which is known by the unusual word, *supralapsarianism*. In simplest language, *supralapsarianism* stands for a sequence of events, awkwardly expressed as follows: (1) first, God decided that man should fall; and (2) then He decided that He would create man. This is a clumsy way of saying that the cosmology of the world, as created, would have death in it as a normal phenomena; or in other words, that the universal physical phenomena of death in the world was not the result of sin but of the earlier decisions of God in regard to creation. This *supralapsarian* view (as distinguished from the primitive *infralapsarian* view) permits a sensible view to be taken of the cosmology of creation and of the world around us.

Distinguished *supralapsarians* in orthodox Protestant churches include the late Abraham Kuyper of the Netherlands; the late Gerhardus Vos, professor at Princeton Theological Seminary; and Herman Hoeksema of the Protestant Reformed Church.

*Supralapsarianism* permits common sense acknowledgement of physical phenomena. It permits a reconciliation of Scripture with indubitable findings of science—which everybody accepts.

In the process, it is desirable to get rid of the idea—as if it were a vestigial organ—that *physical* death as a phenomena in the world at large stems from Adam's Fall.

But *spiritual* death, that is something quite different — that *did* stem from Adam's fall.

Thousands of years after Adam's fall the Apostle Paul worked (in his Epistle to the Romans) on a parallelism between Adam and Christ. He almost over-strained himself, for the parallelism *obviously* is not perfect; orthodox churches acknowledge that. It is not justified, therefore, on the basis of that *partial* parallelism to infer that Adam died *physically*, only *because* he ate from the Tree of the Knowledge of Good and Evil.

Adam's physical death was predestined, earlier, before his creation, as the supralapsarians indirectly and obscurely teach; but his spiritual death was initiated by his rebelling against the obligation established by his being created as he was created — with adequate knowledge to understand the necessity of living according to the terms of a *contract* society rather than a *coercive* society.

## Niebuhr, Barth, Tillich And Nygren On Property Rights

If the test which God applied to Adam in regard to not eating from the Tree of the Knowledge of Good and Evil was designed to designate the "right of private property" — what have the world's most-influential, living Protestant theologians said directly, or by implication, about that? Can they be expected to be prepared to accept the particular interpretation of the symbolism of the Tree of the Knowledge of Good and Evil which has just been presented? Probably not, for how could they accept it, considering that they are socialists, or are ex-socialists, or that they have accepted an ethical proposition underlying the formula, From each according to his ability to each according to his need.

The essence of socialist teaching about property and income is that nobody may reserve property to himself in preference to the rest and remain moral. Everything belongs to everybody. In that premise, the Tree of the Knowledge of Good and Evil could not validly be reserved by God for Himself. Adam on that basis had as good a title to the Tree as God had. The "symbolism" of *ownership* of the Tree of the Knowledge of Good and Evil must be meaningless to a socialist.

The socialist doctrine, From each according to his ability to

each according to his need, in practice has a corollary to it, namely, that every man is his own judge of his *need*. What *he* thinks *he* needs is, in practice, the criterion. (This, incidentally, is a negation of the Tenth Commandment which forbids coveting.) In the Garden of Eden story Eve played the role of deciding what she needed, or wanted in pure caprice, and consequently what she would eat, that is, she operated on the socialist principle of claiming and seizing according to her own subjective appraisal of need or want.

Adam and Eve were "doomed" by God to penalties for their sin. But the penalty was not an arbitrary one. The penalty was causally related to the sin which had been committed, and to the principle underlying the sin which had been accepted. The sinners forthwith became perverted and impoverished.

The same "cause and effect" is evident today in the world around us. Rejection of the right of private property has NOT enriched the nations. The peoples in Poland, Czecho-Slovakia and Jugo-Slavia have in welfare fallen far behind their fellow men on this side of the Iron Curtain. These are people who once enjoyed some degree of freedom of property ownership, that is, freedom of capitalism. Now they may not really *own* property. Their *incentive* to work, save and enjoy is sufficiently reduced so that capital is neither created nor conserved as formerly.

It is probably because he cannot ignore that fact, plus the undeniable evidence of ruthless oppression in communist countries, that Niebuhr has moved away from socialism.

Two of the other men in the list have also experienced frustration with socialism. Tillich's Religious Socialism turned out to be a fiasco, feckless and ludicrous. Barth is an *ex-socialist* (according to Niebuhr) with two additional characteristics, softness toward communism and escapism into theological logomachy.

The "symbolism" of the Garden of Eden narrative is applicable further. Adam and Eve acted *jointly* in eating from the Tree of the Knowledge of Good and Evil, although Eve took the initiative (the testimony appearing to be that she was the more forceful personality). Niebuhr wrote a book years ago, *Moral Man and Immoral Society*, which had the theme that society collectively should be permitted to do what would be immoral for an individual man to do. This was a most dangerous propo-

sition. In the symbolism of the Garden of Eden, that, in effect, says that when Adam and Eve *agreed* collectively to take — seize — the fruit of the Tree of Knowledge, then the act was moral, merely because there was *joint* action. Robbing others of property by collectively-made laws is legitimate, if that formula is accepted.

It should also be noted that the consequences of destroying property rights in the Eden story is experienced today without fail. What people do not have the right to enjoy personally, they waste. They do not exercise thrift, then laboriously fabricate something, and then conserve it carefully — when it is not for themselves. The Garden of Eden was “wasted,” too; Adam and Eve were, in obvious symbolism, obliged to move elsewhere. God, by driving them out, symbolized that if they would not recognize His property right (reserved to only one tree in the whole Garden), they should move out of the Garden and be wholly on their own. The way for them to learn was not to have capital given to them, but to be obliged to create it themselves first. In a sense, God decided to let the Garden go to waste, if nobody was to have *ownership* in it.

One of the aggressive teachings of “Christian” socialists is that property should be “given” to the underdeveloped nations. These gifts are largely socialistic in origin (by progressive taxation) and they are socialistic in character for the recipients. The United States does not give capital to *private individuals* in foreign countries, but to the governments of those states. These socialistically received gifts are subject to a strong tendency to waste, because the recipients often do not really believe in capitalism, and because the United States has exported “socialistic ideas” simultaneously with the “physical capital” that it exported. The former (socialistic ideas) is doing more damage than the latter (physical capital) is doing good.

## Niebuhr's Disillusionment With Socialism, And His New Solution To Social Problems

### Eschatological Utopianism

The *doctrine* that has dominated every other in the Protestant churches in the United States in the latest quarter century is the *Social Gospel*.

That, of course, is not “the gospel,” because if it were, then

it would not be necessary to prefix the word *social* in the term. But the prefix is added, and that is conclusive evidence that it is different from the historic gospel of salvation in a life to come.

Wonderful bliss in a future life can be called the Kingdom of God, or it can be designated, as it is by Niebuhr, as *eschatological utopianism*.

*Eschatology* is defined as "the branch of theology that treats of death, resurrection, immortality, the end of the world, final judgment, and the future state." *Utopian* is defined as something "excellent, but existing only in fancy or theory." There is an undertone of ridicule regularly associated with the word, *utopian*.

The critique of Niebuhr is that the pietists—the old-fashioned orthodox Christians—in the church concern themselves too much with eschatological utopianism and that they do not concern themselves enough with the practical affairs of this life, that is, that they do not work hard enough on the problems of human welfare (or more exactly, *comfort*) in this life. The old-fashioned gospel is, then, a not-too-admirable eschatological utopianism.

The old gospel did however yield certain fruits, which are, in reality, some of the best evidences for its intrinsic merit. The old gospel yielded fruits in the form of alms, hospitals, schools, missions. No other group of people has done so much *voluntarily* in these fields as those people who have been influenced by their semi-derided "eschatological utopianism."

### Ideology And The Sociology Of Knowledge

But more was wanted than eschatological utopianism, and to designate what that "more" was, the term *social gospel* was coined. The social gospel is not eschatological utopianism plus voluntary alms, hospitals, schools, and the like. The social gospel is the doctrine that eschatological utopianism plus voluntary charity and uplift is inadequate, and that it is founded on a rotten base, namely, that those who have the means to exercise *voluntary charity* did not acquire those means under an equitable, or just, or Biblical, or Christian system for ordering society. The system which enabled some to engage in this *voluntary* charity is alleged, or implied, to be honeycombed with iniquity in the form of "power" exercised by those people who possess ownership of property. Free markets, individual effort, personal thrift, pursuit of



own welfare — and the consequences of those factors — are inadequate to secure justice, according to the social gospel.

This bad factual situation is alleged to be aggravated by an *ideological taint*. That ideological taint consists in having a warped view, depending on each man's circumstances, unless he is a proletarian laborer in which case he is free from ideological taint. If a man has property and if he has a better than unskilled laborer's income, then he is unable to see economic reality clearly, and only in a skewed, unfair light.

That doctrine is a fundamental one. It says that there is really no objective truth in regard to economic and political matters; a man's ideas are responses to his circumstances; his circumstances control his principles; in order to know what he will think it is necessary to know his circumstances; his ideas are effects and not causes. How good or bad a man is does not depend on *him* but on his environment.

This fundamental attack on the potential unity of knowledge, on a man's mind being free, is known today as the *Sociology of Knowledge*. The term probably was coined by some sociologist who had in mind that his description of a man's environment would provide an understanding of what the man would think, and would permit the sociologist to forecast the man's reaction to events. In short, men are not really *free* in their thinking; instead their environment controls their thinking. Men are irresponsible for their thoughts, because their thoughts are controlled by natural law. Human thought is only one dependent link in a causal chain, as a chemical reaction is a dependent link in the same chain.

The *sociology of knowledge* is the so-called "scientific" explanation of *ideology*. Ideology is your subjective, *biased* slant on life, particularly on economic matters. If a man is a *bourgeois* (that is, somebody other than a proletarian) his ideology is a product of his favored economic position. Anything and everything he thinks is supposed to be prejudiced in his own favor because of that. You can, therefore, have no real sense of *justice* to your fellows; your ideology has made you irrational despite any effort you make at honesty.

The social gospel has espoused this interesting irrationalism.

That there is a not-to-be-doubted existence of "ideology" is a prominent part of Niebuhr's thinking.

These ideas on ideology and sociology of knowledge stem from Karl Marx. Probably the single doctrine of Marx which has registered on Niebuhr's mind more than any other is this positivistic doctrine of ideology and sociology of knowledge.

If the doctrine, *as Marx propounded it*, is true, then religion is a hallucination, because then that which we think is not an *independent* activity in our life, but is determined by irresistible causes antecedent to any act of our presumed will. If the *sociology of knowledge* is a correct hypothesis, then there is no real freedom of the mind, and consequently there can be no soul, and if there is no soul, religion is a grand hoax.

### The Social Gospel

The essence of the social gospel is that instead of *eschatological utopianism*, a future Kingdom of God, we really need a present-day utopianism, an earthly Kingdom of God, a utopia here and now. Further, the social gospel does not wish to depend on persuasion in order to establish that present-day utopia, but it is so sure of itself that it is prepared to rely on coercion and violence to put the program into effect. The means to that end are to be *state laws* which coerce recalcitrants. These public laws do not have to be reconcilable with moral laws governing individuals; they can do what the moral law positively forbids individuals. This, it appears obvious, is a fatal dualism and inconsistency.

Niebuhr clearly saw that fact several years ago when he wrote his *Moral Man and Immoral Society*. Probably few or no others saw that their social program was based on actions which an individual (according to principles of morality, and certainly according to the Christian religion) might not do. With clarity and honesty Niebuhr proclaimed that moral inconsistency in his book. But the very awareness of the dualism and inconsistency was certain eventually to create a problem for him which he could never escape. Like yeast in dough, that *inconsistency* would eventually change the character of his thinking.

And so the social gospel is not a system promoting voluntary good will or alms. It is a coercive system intending to change the economics of the organization of society. The customary name which designates that coercive economic system, which Protestant

theologians advanced as their this-worldly utopia, as their Kingdom of God here and now, is the name, *socialism*. The *social gospel* is merely an alternative label, adopted by Protestant theologians, for *utopian socialism*, an economic system based on collective coercion.

### Niebuhr's Disillusionment

A man of Niebuhr's critical temperament is always vulnerable to a new disillusionment. In his youth he was probably disillusioned by eschatological utopianism. Now, well on his way to the evening of his life, he has suffered a disillusionment regarding socialist, this-worldly utopianism.

That is the gist of what he writes in his article, "Biblical Faith and Socialism: A Critical Appraisal," which is the fourth article in *Religion and Culture*. In this article: (1) he repeatedly admits that he and his fellow social gospellers suffered from this-worldly utopianism, just as secular Marxian socialism does; (2) that they misinterpreted history in a too-simple and naive manner; and (3) that the social gospel program is a reasoning in a circle; if circumstances are amended as proposed, the poor and weak become rich and/or powerful; roles are reversed; and the same problem exists anew in a different form.

In his review of events Niebuhr makes some statements which are difficult to accept except with reservations, such as, "There were a few Christian 'fellow travellers' but no one with any influence in the Christian church espoused the communist cause" (page 54). Really, so few? To disassociate the social gospel from communism, he writes of Sidney and Beatrice Webb, who have been darlings of the social gospellers, as follows: "In Britain the Liberal Socialist party of MacDonald was too impotent to overcome unemployment, so that the situation prompted those two devoted disciples of parliamentary socialism, Beatrice and Sidney Webb, to flirt with communism and to publish a ridiculous book, in which the Societ claims were taken at their face value: *Soviet Civilization*." Niebuhr has never been a man to spare even his old friends! Further, the most-uncomfortable phase of Niebuhr's earlier book, *Moral Man and Immoral Society*, is its gentleness — almost sympathy — for Communism. There is in it not one unqualified critique of the monstrous immorality that goes by the name of communism. (Of course, Niebuhr has disavowed his earlier writings.)

The crucial fact is that Niebuhr has abandoned socialism as his hope for accomplishing the purpose of the social gospel. That is an event of major significance in the religious and cultural world in the United States — and maybe in the world. In a metaphor, Niebuhr has pulled his car off the wrong road. The next crucial question is: Is Niebuhr now on the right road?

Unfortunately, he is not. He has espoused no new principles. He has turned pragmatist. This is his new interpretation: (1) much of the socialist program is already accomplished under the welfare state (the interventionist program of the New Deal); (2) events have turned out much more complex than the social gossellers realized; their solutions were over-simplified; (3) it is necessary to be more cautious in reaching conclusions, and events have not turned out so catastrophically as the social gossellers pictured them (especially in the Great Depression); by compromise and gradual adjustment much progress has been made; and so (4) let us be less radical and "trim" cautiously between doctrinaire ideas, such as utopianian socialism on the one hand and self-satisfied conservatism on the other.

Maybe this is the mellowness of age; maybe the old warrior has become weary. Almost certainly some events have occurred which have forced Niebuhr to change his mind, events such as (1) the spectacular recovery of West Germany *under free enterprise*; (2) the woodenish follies of the socialist government of England and the trend of British thought away from stifling, socialistic bureaucracy. But Niebuhr is not explicit about *how* he has come to amend his thinking. Candor on that subject might have revealed too much. We all stand, inescapably, before the bar of history. Maybe it was time to touch up the social gospel record so that historical judgment will not be too harsh on it.

But there is no evidence in the essay under discussion that Niebuhr has found the right road. What indications there are in the essay point to the conclusion that Niebuhr understands no more of economics than formerly. He has merely reached a conclusion that his old ideas were defective. He has not reached a conclusion which indicates that his future thinking will be right; merely that it will be different.

## **Finding One's Way Through The Labyrinth Of Economics**

The Social Gospel, if it is an erroneous program, can be discredited by calling attention to its fallacies, or by waiting to let consequences demonstrate that it is harmful. By the first method, the critique pertains to causes and the conclusion is predictive. By the second method, a conclusion is obtained from the effect, and the findings are merely history; it is too late to do anything about it. Niebuhr is not reasoning from *causes*, but from territorial *effects*, in certain geographical areas, as the United States, in Iron Curtain countries, and probably in non-socialist West Germany. He does not reason from causes. It is not possible to do so unless one has knowledge of economics.

\* \* \*

Adam Smith and David Ricardo are two of the most illustrious names in economics. But they came early in the history of the science. They worked marvelously, but (from the viewpoint today) defectively. Their position on several vital economic questions was Janus-faced — contradictory. This was not deliberate error nor hypocrisy, but they had not "thought through" the problems. Of two contradictory positions one would naturally be better and the other worse. Karl Marx came along later and rather systematically and slavishly accepted the worse. Then the Social Gospel came along and adopted the bad economics of Marx (derived from the worse of the contradictory positions of Smith and Ricardo), and then united Marxian economics with bad ethics by misunderstanding the teachings of the Hebrew-Christian religion. Bad economics is the father and bad ethics is the mother of the Social Gospel.

Seventy-five years ago a "revolution" took place in economics. This was the Neo-classical movement. This movement was also based on Smith and Ricardo, but in this instance their more-correct ideas were utilized, and a great additional development occurred. The principal names in this situation were Carl Menger, Eugen von Böhm-Bawerk, Friedrich von Wieser, Ludwig von Mises. If the leaders of the Social Gospel would read the works of these men, they would be shook loose from the bad economics of Marx and would be induced to improve their ethical doctrines.

It is futile to expect an intrinsic improvement in the ethico-economic ideas of the Social Gospellers unless they improve their economics. And there appears to be no way for them to improve their economics unless they read the works of the Neo-classicists.

\* \* \*

One of the difficult ideas genuinely to grasp is that the relationship of men to things is antecedent to, or at least a vital part of, problems which derive from the relationship of men to men. The inclination of a theologian is to begin with and stay with the relationships of men to men. But the relationship of men to men must be seen in the relationship of men to things.

Böhm-Bawerk years ago wrote ("The Austrian Economists," *Annals of the American Academy of Political and Social Science*, January 1891) on that subject as follows (our italics):

What they [the Neo-classicists] are striving for is a sort of "renaissance" of economic theory. The old classical theory, admirable as it was for its time, had the character of a collection of fragmentary acquisitions which had been brought into orderly relations neither with one another nor with the fundamental principles of human science. Our knowledge is only patchwork at best, and must always remain so. But of the classical theory this characterization was particularly and emphatically true. With the insight of genius it had discovered a mass of regularities in the whirlpool of economic phenomena, and with no less genius, though hindered by the difficulties that beset beginnings, it commenced the interpretation of these regularities. It usually succeeded, also, in following the thread of explanation to a greater or less distance from the surface toward the depths. But beyond a certain depth it always, without exception, lost the clue. To be sure, the classical economists well knew to what point all their explanations must be traced — to the care of mankind for its own well-being, which, undisturbed by the incursion of altruistic motives, is the ultimate motive-force of all economic action. But owing to a certain circumstance the middle term of the explanation, by means of which the actual conduct of men, in the establishment of prices of goods, of wages, rent, etc., ought to have been joined to the fundamental motive of regard for utility — this middle term was always wrong. That circumstance was the following: A Crusoe has to do *only with goods*; in modern economic life we have to do (1) with goods and (2) with human beings from whom we obtain the goods we use — by means of exchange, cooperation and the like. The economy of a Crusoe is explained when we succeed in showing what relation exists between our well-being and material commodities, and what attitude the care for our well-being requires us to take toward such material commodities. [But] To explain the modern economic order there is, apparently, need of two processes: 1st, just as in Crusoe's economy, we must understand the relation of our interests to *external goods*;

2nd, we must seek to understand the laws, according to which we pursue our interests when they are *entangled with the interests of others*.

No one has ever been deluded into thinking that this second process [the relation of men to men] is not difficult and involved—not even the classical economists. But, on the other hand, they fatally under-rated the difficulties of the first process [namely, the relation of men to things]. They believed that as regards the relation of men to external goods, there was nothing at all to be explained, or, speaking more exactly, determined. Men need goods to supply their wants; men desire them and assign to them in respect of their utility a value in use. That is all the classical economists knew or taught in regard to the relation of men to goods. While value in exchange was discussed and explained in extensive chapters, from the time of Adam Smith to that of Mr. Macvane, value in use was commonly dismissed in two lines, and often with the added statement that value in use had nothing to do with value in exchange.

It is a fact, however, that the relation of men to goods is by no means so simple and uniform. The modern theory of final [or marginal] utility in its application to cost of production, complementary goods, etc., shows that the relation between our well-being and goods is capable of countless degrees, and all these degrees exert a force in our efforts to obtain goods by exchange with others. Here yawns the great and fatal chasm in the classical theory; it attempts to show how we pursue our interests in relation to goods in [relation] to other men *without thoroughly understanding the interest* [which we have in those goods themselves]. Naturally the attempts at explanation are incoherent. The two processes of explanation must fit together like the two cogwheels of a machine. But as the classical economists had no idea what the shape and cogging of the first wheel should be, of course they could not give to the second wheel a proper constitution. Thus, beyond a certain depth, all their explanations degenerate into a few general commonplaces, and these are fallacious in their generalization.

This is the point at which the renaissance of theory must begin, and thanks to the efforts of Jevons and his followers, as well as to the Austrian school, it has already begun. In that most general and elementary part of economic theory through which every complicated economic explanation must eventually lead, we must give up “dilettante” phrases for real scientific inquiry. We must not weary of studying the microcosm if we wish rightly to understand the macrocosm of a developed economic order. This is the turning-point which is reached at one time or another in all sciences. We universally begin by taking account of the great and striking phenomena, passing unobservant over the world of little everyday phenomena. But there always comes a time when we discover with astonishment that the complications and riddles of the macrocosm occur in still more remarkable manner in the smallest, apparently simplest elements—when we apprehend that we must seek the key to an understanding of the phenomena of great things in the study of the world of small things. The physicists began with the motions and laws of the great heavenly bodies; to-

day they are studying nothing more busily than the theory of the molecule and the atom, and from no part of natural science do we expect more important developments for the eventual understanding of the whole than from the minutiae of chemistry. In the organic world the most highly-developed and mightiest organisms once roused the greatest interest. Today that interest is given to the simples micro-organisms. We study the structure of cells and amoebae, and look everywhere for bacilli. I am convinced that it will not be otherwise in economic theory. The significance of the theory of final utility does not lie in the fact that it is a more correct theory of value than a dozen other older theories, but in the fact that it marks the approach of that characteristic crisis in the science of economic phenomena. It shows for once that in an apparently simple thing, *the relation of man to external goods*, there is room for endless complications; that underneath these complications lie fixed laws, the discovery of which demands all the acumen of the investigator; *but that in the discovery of those laws is accomplished the greater part of the investigation of the conduct of men in economic intercourse with one another.* The candle lighted within sheds its light outside the house.

\* \* \*

In his article on "Carl Menger" (1840-1921) in his *Ten Great Economists*, Joseph A. Schumpeter wrote:

Menger belongs to those who have demolished the existing structure of a science and put it on entirely new foundations.

Evidence is lacking that any of the Social Gospellers has read Menger's writings.

\* \* \*

Schumpeter in the same book, in his article on "Eugen von Böhm-Bawerk," (1851-1914) wrote:

. . . [Böhm-Bawerk] became one of the five or six great economists of all time.

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Economics, As An Ally Of Morality

Whereas *morality* is the primary *objective* of this publication, *economics* is its specially selected *method* to obtain a new insight into morality.

Via the route of economics, this publication comes to conclusions which are harmonious with ancient, revealed principles of morality.

Principles of morality, far-sighted judgment, and the findings of the science of economics are identical. (We are not referring to pseudo-economics.)

Economic society has always been complex, but especially now. When economics is enlisted to help understand present-day society, then ancient principles of morality will be found to be as salutary as at any time in the past.

## The Cultural Mandate

Adam, it is alleged by some theists, was given a *cultural mandate*, namely, to "subdue" the earth, and to have "*dominion*" over everything in it. The earth and the things in it became, as this cultural mandate is incorrectly interpreted, the purpose of man's existence *in this dispensation*. According to that interpretation, man must serve creation, rather than creation serve man. This is a notion which appears nonsensical.

A pantheist, with a mystical idea of the unity of the universe, might believe in such a cultural mandate in honor of that mystical unity; but a theist, *no*.

Rightly or wrongly, when the issue is between man and universe (not between man and God), we consider the universe to have been created *for man*, not man for the universe.

The cultural mandate as usually understood confuses goals. Certainly, the earth was to be "subdued" and ruled over by men but *for their own welfare*, not in order to serve a mystical mandate.

The cultural mandate is a lower goal than altruism. In the case of altruism men must serve other men, but under the cultural mandate men must serve the possibilities inherent in the world around us, with everything in it, dead or alive. Of three choices, the cultural mandate is lowest; next, altruism; the highest is individualism, correctly understood.

## Individualism versus Altruism

The proposition advanced in this issue and the next is that "selfishness" is not a mechanism by which society is blown apart, but by which it is, in fact, cemented together. This may sound paradoxical, but it is not.

By "selfishness" is meant self-preservation and self-welfare. These are motives which are legitimate and virtuous. (Some motives, those to harm others, are sinful.) But the principal perpetration of evil consists primarily in the use of *illegitimate means* (coercion, theft and falsehood) in order thereby to promote self-

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preservation and self-welfare. The fertility of the human mind to sin, under those categories, is phenomenal.

The foregoing definition of sin is radically more restrictive than the prevailing one in Christian churches.

The pursuit of self-preservation and self-welfare is associated with the name, *Individualism*. In FIRST PRINCIPLES, individualism is openly and systematically espoused. In the Christian church *individualism* is generally considered to be deficient, and either not Christianity, or at best only a low form of Christianity.

The antonym which is the opposite to the pursuit of self-preservation and self-welfare is *Altruism*, the doctrine that you must devote yourself to others rather than to yourself. This is the prevalent doctrine in Christian churches.

Our thesis is that individualism, *correctly understood*, binds men together, whereas altruism, even when not sanctimony and arrogance (which it often unwittingly is), will blow society apart, and will be a bane to men.

But considerable explaining will be necessary before this is understood and accepted. The road to understanding in this case is the road of economics, via the *subjective theory of value* and the concept of *marginal utility*, both developed by the neoclassicists in economics, especially the so-called Austrians. These two ideas appear to be seldom, if ever, understood in religious or philosophical circles.

## Recapitulation Of The Contents Of The February Issue And Introduction To This Issue

In the February issue an interpretation, as kindly as it could possibly be, was given of the social gospel.

That "gospel" appears to have turned out to be less gratifying to some of the social gospellers themselves than they had expected.

\* \* \*

One of the most talented social gospellers, Reinhold Niebuhr, in recent years has disclaimed responsibility for what he had written in earlier years on this subject; and in an essay published in 1959, in a book in honor of Paul Tillich, he (Niebuhr) makes it clear that for him the program of Marxian socialism is no longer his authentic hope for the social gospel, or an earthly Kingdom of God.

There are *two* aspects of that fact that are worth noting:

(1) Niebuhr indicates that the social gospel's program is essentially a program based on Marxian socialism; this is an acknowledgment that should help correct those who have refused to concede that they borrowed the substance of their social gospel from socialism, and that they merely baptized it with the name of "gospel" and "Christianity"; and

(2) When the man at the apex of the social gospel hierarchy of intellectuals shifts his position, then that phenomenon should be evaluated as one with potentially major consequences.

But the information in the February issue was accompanied by a warning that, although Niebuhr has put a question mark behind Marxian socialism being the proper "content" of the social gospel, *he has not found a genuine alternative*. He has not been able to discover an alternative that genuinely satisfies him. He has become a "trimmer," compromising between doctrinaire socialism and a semi-capitalistic alternative. He has not yet discovered, we believe, those social, political and economic *principles* which the situation requires.

\* \* \*

Further, in the February issue the cause of this half-way and compromising position of Niebuhr was ascribed to a defect in his education, almost certainly a "chance" factor, namely, a lack of knowledge of economics. Chance plays a part in what every man learns. In this respect fortune has not been kind to Niebuhr.

Further, attention was called to the "frame of reference" that fundamentally affects the relations of men to men, namely, *the relation of men to things* (or more accurately, to *economic goods*). In their dealings with each other men do not live in an infinite world, but in a very finite world, and so the finiteness of the supply of economic goods is of primary importance.

When a thing is needed and scarce, it is, in economic terminology, an *economic good*, as well as a thing. The relation of men to men is then *determined* in part by the relation of men to those things that are called economic goods — that is, things that are both *needed* and *scarce*.

There need be no fear of dispute, by the social gossellers nor among others, about the relation of men to mere *things*, that is, objects which are neither wanted nor scarce. The controversy,

by common sense and by definition, is necessarily limited to what is needed and is scarce, that is, to *economic goods*.

When the social gossellers take offense concerning the *scarcity* of goods, they are rebelling against the kind of world in which we live. They are resenting the *created* cosmology.

The world, from the beginning, was finite. The "cosmology" taught in the creation story in the Hebrew-Christian Scriptures emphasizes that there was and would continue to be a *welfare-shortage*. The command given to Adam was to go to work and "dress the trees" in the Garden. If the trees were "perfect," in the sense that *nothing* needed to be done to them and that they would yield an adequate supply without cultivation, it would have been unnecessary to instruct Adam to go to work. The welfare-shortage is creational; it does not essentially derive from the Fall, although the Fall aggravated it.

When Adam rejected a *cooperative*, or *contract* society (by indicating he would not observe the ownership rights of others, in this case symbolized by the ownership which God explicitly retained in the fruit of the Tree of the Knowledge of Good and Evil), he suffered a causal penalty — to wit, work would be more burdensome than it otherwise would be; because in a genuine *contract society* the *quantity* of capital and of economic goods would have been greater than it could be, and turned out to be, in a *coercive* society.

The choice presented to Adam was whether he would live up to his natural endowments which were far greater than those given to the beasts, and whether he would substitute a cooperative society for a tooth-and-claw society — a contract society in place of a bestial society. He failed.

The utopias, which have been fabricated in the minds of men who lack a clear sense of reality, have always involved disregard of the reality of a universal *welfareshortage*. The classic modern example of utopianism is socialism. Its main appeal is its promise of *boundless* welfare. It denies the universality of the welfare-shortage in all time and in every place. Socialism reveals itself to be nonsensical when it expects that the shortage of *economic goods* will end when the *ownership* of goods will end. The fact is that the shortage of economic goods *always* becomes worse when there is no acknowledgment or protection of the right of ownership.

The unrealistic utopianism of socialism — that the welfare-shortage of goods would come to an end with the ending of ownership of goods — that fantastic lack of realism has also been close to the heart of the social gospel (as Niebuhr has now conceded).

Finally, it was declared in the February issue that the best source from which to obtain a realistic knowledge of the economic cosmology of the world is from the neoclassical school in economics. This school consists of William Stanley Jevons, an Englishman; Carl Menger, Friedrich von Wieser, Eugen von Böhm-Bawerk, Ludwig von Mises, Friedrich von Hayek — all Austrians; Carl Wicksell, a Swede; Frank A. Fetter of Princeton, an American; and, naturally, many others.

In the February issue we mentioned the Austrians only, because they did the most complete and best work; they were associated in a "school of thought," and so fertilized each other. Furthermore, when their books are read in the right sequence — Menger's, Wieser's, Böhm-Bawerk's, Mises's — they are not difficult reading (although otherwise they are).

Menger's principal work, on which all the others built, is easy reading. In the February issue, in regard to Menger, we quoted the late Professor Joseph A. Schumpeter: "Menger belongs to those who have demolished the existing structure of a science [economics] and put it on *entirely new foundations*" (*Ten Great Economists*, p. 83, Oxford University Press, New York, 1951). The italics in the quotation are ours. The social gospellers have not discovered this Mengerian economic revolution, probably because they found it difficult to read the German text.

Economic thought in America has been only insignificantly influenced by the Austrian neoclassical school. American text books do reveal some knowledge of *final utility* or *marginal utility* as a controlling principle in the relation of men to goods, and those books give it a brief description, but the summarizations fail to do justice to the basic ideas. Abbreviating too much or elaborating too much has the same effect; it reduces the force and clarity of the presentation. That observation is applicable to the summaries, in the English language, of the ideas of the Austrian neoclassical school — the *abbreviations* have weakened the presentations so that they are inadequate.

Americans are poor linguists. The Austrians wrote in the German language. What has long been needed are English translations of the final works of the Great Austrians. The following list *and dates* show how recently it is that English translations have become available.

Carl Menger: *Principles Of Economics*, The Free Press, Glencoe, Illinois, 1950, 320 pages, \$6. (Of these 320 pages, 40 pages are an "Introduction" by Frank H. Knight, which should be read only *after* the book itself has been read.)

Eugen von Böhm-Bawerk, *Capital And Interest* (three volumes), Libertarian Press, South Holland, Illinois, 1959, \$25.

*History and Critique of Interest Theories*, 512 pages

*Positive Theory of Capital*, 480 pages

*Further Essays on Capital and Interest*, 256 pages

Friedrich von Wieser, *Natural Value*, Kelley and Millman, Inc., 1956, 243 pages, \$7.50. (This is a reprint.)

Ludwig von Mises, *Human Action*, 1949, 881 pages, \$12.50; *The Theory of Money and Credit*, new enlarged edition, 482 pages, 1953, \$5; and *Socialism*, new enlarged edition with an Epilogue, 1951, 592 pages, \$5. (All Yale University Press.)

It is only in the latest ten years that these books have become available to Americans in their own language; they will create a "revolution" in economic thought in this country, but it is too early to expect it now.

The foregoing assertions may be unimpressive, but only as long as the books in the foregoing list have not been read, pondered, and applied. If the social gossellers would do that, then they would discover that there is an effective way to establish their yearned-for Kingdom of God, on this Earth, in the present life of men. Or, if only a few of their leaders with the influence of a Reinhold Niebuhr, would become economists — not in the obsolete classical sense, but in the neoclassical sense — then a yeast would begin to work which would give a rebirth to the social gospel program of an earthly Kingdom of God.

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This ideal of liberty is fully realized when every individual is absolutely free to seek his own interest or follow his own inclination in every possible way which is pleasing to himself and not harmful to the rest of society.

Thomas Nixen Carver

## The Attack On Private Property By Those Who Profess The Old-Fashioned Gospel

It would be an error to say or imply that it is the social gossellers *only* who are tainted with the basic ideas of socialism. Christians who are otherwise orthodox, and who strongly attest to their own orthodoxy, take views not essentially different from the ethical views (which are socialistic) of the social gossellers. It will be well to consider an example.

In Canada there are two professed *Christian* labor organizations. One has the name of *Christian Labor Association of Canada*; the other, *Christian Trade Unions of Canada*. In this article we are referring to the latter. Its official organ is *The Voice*, and the editor is F. P. Fuykschot, a Canadian born in the Netherlands, and holding those ideas about the organization of society (and the position of property and labor in it) which are held by some in that land.

If Fuykschot wrote the unsigned lead article in the February-March 1960 issue of *The Voice*, it is obvious that he does not consider the right to private property as *basic* to a human society, nor that private property is an *essential* feature of the Christian religion. The following is quoted from the article mentioned:

Does the Bible choose between communal and private property?

Many Christian scholars in our time and generation as well as in past centuries have answered this question in the affirmative. They state that private property is the system chosen by God for mankind. Some say that communal property was in effect before man fell in sin. But the sin of man made communal property impossible, so now private property is required. Other theologians have another opinion and state that private property has always been the only possibility. Again others consider themselves unable to take a stand in this matter at all.

*After having studied the matter we are on the side of those who say that the Bible does not make a choice at all in the question of private or communal property.* [Our italics]

We believe that private property is a gift of God. Those who believe that will be more concerned about how to spend it in such a way that God's approval may rest on it, than about how to increase it. And everyone who has private property, however little, may search his own life and heart thoroughly to find out whether the Lord gave it to him or whether he acquired it by means which are detestable before God.

We also feel that it is beyond doubt not God's aim that private property be piled up by a few while 90% of



the world's population is stripped even from the necessities of life. The prophets of the Old Testament are very definite in this opinion. They condemn the accumulation of riches just for the sake of piling up wealth: "For they know not to do right, saith the Lord, who store up violence and robbery in their palaces." (Amos 3:10).

Likewise the opinion of many Christians that the right of having property and how to use it, is unassailable, is wrong. That was the opinion of the old Romans. They claimed that the use of their wealth was their own and nobody else's business. This opinion is still widely spread in our generation. Every infringement of this right, even by a Government, is condemned by them. They consider this right as a mere *material* right. The proprietor only may dispose of his goods. Many Christians add that a man is responsible for his property and the use of it before God only. That sounds good but nowhere does the Bible teach us that the Lord is concerned or interested in the wealth of a man. He is concerned about the heart of man that it is right before Him.

The Bible approaches the right of private property in a different way. In the Bible every word about property and wealth is permeated by a spirit of compassion for the poor. Property has the aim to serve God and the neighbour. The Bible does not emphasize the *right* of the owner, and the *obligations* of the poor, as we often do. To the contrary. Nowhere clearer than in the Mosaical law (Lev. 25) the owners are charged with *obligations* and the *rights of the poor* are stressed. On what ground? On the ground: "For he is your brother." That is the significance of *stewardship*.

It would be worthwhile to investigate how this stewardship is treated or rather mistreated in actual economic life. Capital goods and money are used to build up big companies, men are hired at the lowest possible rate because capital must produce profit. As soon as business is slack the employees are dismissed and left at the mercy of the government and the community. This kind of "Stewardship" is indeed wide apart from what the Bible teaches us. In Israel such an attitude of owners is most strongly condemned. Social legislation had the object in Israel to make strong stipulations for the use and disposal of private property in the name of mercy and compassion to the poor.

In the light of the Holy Scriptures our actual society falls terribly short from the meaning of God about private property.

Now if the Bible does not choose between communal and private property, between the right of the community and of the individual what is the intent of God? Wouldn't it be that both the individual and the community have their respective rights?

Private property is a necessity for the life of every man. This does not mean that wealth in the modern sense of the word, is required. It is the Christian's prayer: "give me neither poverty nor riches; feed me with food convenient for me: lest I be full, and deny Thee, and say, Who is the Lord? or lest I be poor, and steal, and take

the name of my God in Vain." (Prov. 30:8, 9) Here the significance of private property is brought back to its right dimensions. It is also true, however, that the dignity of man calls for a sphere of freedom and that pre-supposes property of some kind: food, raiment, housing. The expression we all know, that the world should be made free of want, has a Christian foundation, although it seems hard to realize that condition.

Here we touch on the needs of whole communities. How fortunate that God did not choose for private property but also cares for communities. The life of the individual has its needs, but also the life of communities. Apparently God is aiming at *harmony* between the individual needs and the needs of the communities. Sin has disturbed harmony but Jesus Christ, the Mediator between God and man, has fulfilled all the conditions to restore this harmony. We, men, have to seek this harmony again in human relations, especially in economic life.

There is hardly a realm of life where human relations are so much in turmoil than is the case in economic life. And there is hardly a problem more closely related to property and capital requirements than in the economic and social realm. The growth of communistic influence as a consequence of the neglect of the need of community is perhaps the most strong evidence that something was wrong in society. Even in the so-called free world there is evidence of the need of harmony in the relations. The number of work stoppages, the hard feelings between employers and employees, are indications that we need a new orientation in the matter of communal and individual property from a Christian point of view. That point of view can only be the law, proclaimed by Christ in Matt. 22:37-40: Love God and thy neighbour as thyself.

Exactly that is the goal of the Christian labour movement: to reform society according to the law of love.

A better and scriptural understanding of the right role of private property in human life is required to change the disposition of leaders and followers. We Christians have become so accustomed to an economic system which ignores completely God's law that we think it is essential to keep it unchanged.

Social life in industry has been in a state of development ever since social legislation and the organization of workers and employers began. During this development various principles and forces have been gaining ground. We are in a struggle to find the right meaning of, and the right direction between freedom and restriction of freedom, between the personality of man and the community, between private and communal property.

It is a struggle for the soul of man, of employer and employee, and as our guide we have Holy Scriptures.

We don't know where this will end but we go in faith, like Abraham, who went his way in obedience, not knowing whither he went.

The Bible, the writer says, takes no position on private property. If so, how can there be a commandment against theft?

*Theft* involves the ideas of *rightful* ownership and *wrongful* ownership. What other meaning can be implied by the word, theft?

\* \* \*

He considers "property a *gift* of God" (our italics). No theist will question God's providence and rule over all, but are we to ignore the consequences from one man's industry and thrift, and another man's idleness and self-indulgence? When men talk of the "gifts" of God, that *generality* may become meaningless. There are intermediary, direct, human causes which are "the causes that count." It is well to keep them in mind, or else there will be little commonsense left.

\* \* \*

Further, the article quoted indicates that communal action may supersede the rights of individuals in regard to property. What is behind that idea is probably the same immoral idea that Niebuhr had the clarity and candor to put into words at one time (when he believed them, although maybe not now), to wit, that *men collectively may do morally what it would be immoral for men to do individually*. Only when men restrict their claim to the right to do collectively what they have the right to do individually is there an obviously defensible principle underlying collective conduct.

\* \* \*

The reference by the writer in *The Voice* to Chapter 25 in the Old Testament book of Leviticus fails to convince. That the Mosaic legislation there promulgated provided for return of particular plots of land to the original owners or their descendants is perfectly clear. But that system did not last, probably because it was not workable or successful. What was legislated in Leviticus 25 is of no significance today for practical purposes, and will remain that way.

Leviticus 25 provides that every 50th year — the Jubilee year — land would be restored to the man who had a claim to it on the basis of family membership or inheritance. Leviticus 25:10-13 reads:

"And ye shall hallow the fiftieth year, and proclaim liberty throughout the land unto all the inhabitants thereof: it shall be a jubilee unto you; and ye shall return every man unto his possession, and ye shall return every man unto his family. A Jubilee shall that fiftieth year be unto you: ye shall not sow, neither reap that which groweth of itself in it, nor gather the grapes in it of the undressed vines.

For it is a jubilee; it shall be holy unto you: ye shall eat the increase thereof out of the field. In this year of jubilee ye shall return every man unto his possession."

Suppose that one year *before* the jubilee year you acquired a farm from a man indebted to you. In the negotiation with him at that time, what would you estimate the farm to be worth? Obviously, no more than *one* year's net income, because you would not be permitted to keep the farm more than one year. You would certainly not credit him with the full value of the farm as you would if you might keep it permanently.

If, on the other hand, you obtained the farm from him, in settlement of a debt to you, in the first year *after* the jubilee year, you would credit the debtor in that settlement with a valuation on the farm equal to the income for 49 years (less the discount for time). How the Israelites made their calculations under this jubilee year legislation was: they did not price farms on the basis of ownership under fee simple titles but as being "leaseholds," and their prices varied depending on the length of the time the "leasehold" had yet to run.

There is a rather certain judgment to be made of this jubilee year arrangement, and that is that Moses made a mistake. Imagine that in every fiftieth year nobody farmed in the United States!

Moses himself fully realized what he was doing and that the value of land under this legislation would be priced at its unexpired leasehold value up to the jubilee year. He says in verses 15-16:

"According to the number of years after the jubilee thou shalt buy of thy neighbor, and according unto the number of years of the crops he shall sell unto thee. According to the multitude of the years thou shalt increase the price thereof, and according to the fewness of the number of the crops doth he sell unto thee."

What did Moses *instruct*? He told the Israelites to price farm lands "according to the multitude of the years" and "according to the fewness of the years." There was, therefore, *no real redistribution* of wealth involved in the arrangement associated with the jubilee year. The writer of the article in *The Voice* is, therefore, in error if he thinks that the legislation in Leviticus 25 is ideal legislation, or practical legislation, or legislation resulting in significant redistribution of wealth.

\* \* \*

The writer of the article in *The Voice* expresses his ill-will to the rich. They should not have much when others have little. This is a problem which may be considered at another time, but it should be noted here that either all people who have private property are wrong-doers because of that, or else some are wrong-doers and others are not. That some people may be possessors of property which they have obtained *improperly* (whether little or much, is not significant in this case) is not to be disputed. If it can be proved that they obtained their property improperly, then legal procedures should be instituted against them and *they should be dispossessed*. This is a problem that should be corrected under the present law.

But what about property owners, small or large, who obtained their property *honestly*? According to the writer in *The Voice*, their claim to ownership is as much subject to dispossession as the dishonest holders. "Society" is authorized, so the argument goes, to take it away from them, in part or in total, because no title to any property is good when questioned by the "community." That argument is essentially socialistic. The social gospel goes no further than the writer in *The Voice*.

\* \* \*

The writer also appeals to Proverbs 30:8-9: "Give me neither poverty nor riches . . ." He then says that modest living and approximate equality are all we should want; we do not need "wealth in the modern sense."

But we all *want* it. The rich want *more*; the poor *clamor* for it; the peoples in poor nations *demand* it. The prayer for mere subsistence hardly "rings true" today in the United States. There is no Christian labor union anywhere in the world whose policy is to be reconciled with the prayer in Proverbs 30:8-9. The demand is always, *more*. (The chapter from which the quotation is taken has other difficult passages in it; the chapter is poetical in structure, and allowance must be made for that.)

\* \* \*

Having first questioned whether the Bible sanctions private property, the writer later alleges that "private property is a necessity for the life of every man"; it is not possible to reconcile that with what he wrote earlier that "the Bible does not make a choice at all in the question of private or communal property." If the

latter quotation is true, why does he base any argument on Scripture, which does not speak definitely on the subject. Why not then set Scripture aside on economic questions.

Finally, the writer in *The Voice* strikes an empirical or trial-and-error note. We have not, he indicates, for modern times found the answer yet "in the matter of communal and individual property from a Christian viewpoint." We need a "new orientation." This yet-to-be-discovered principle comes rather late. Thirty-five hundred years after Moses, and yet no *principles* on private property, that is, no basic principles yet which are good on that subject for all time!

What has he written? This: (1) the Bible does not take a position; (2) the Bible does take a position; (3) the right position is yet to be discovered empirically.

This material is proof how orthodox, old-fashioned-gospel men are confused on economic questions. They have not studied economics, or if they have thought that they have studied in that field, they have studied pseudo-economics.

### Unions Which Claim To Be Christian Differ Between Themselves

As previously indicated, there are two labor unions in Canada which claim the title of Christian. In the previous article a quotation from the official organ of The Christian Trade Unions of Canada, *The Voice*, was presented. In the same issue there is an article against the rival Christian labor union, The Christian Labor Association of Canada. The article follows:

The Christian Labour Association of Canada: (not to be confused with the Christian Trade Unions of Canada) is it a *labour union* or is it an *employers' association*?

From a two-paged pamphlet published by the Christian Labour Association of Canada, 440 Chatham St., Brantford, Ontario, entitled: *Hands meet at the Cross*, I quote this passage: "Employees should *not* place their collective power over against the economic property control of the employer." This is obviously a positive stand which definitely aligns itself with management but which is expressed in a negative assertion.

This attitude of negativism which clearly brands the CLAC, is an indication of their basic moral irresponsibility to society. It marks out a regressive trend which can reach its logical conclusion in a social order which existed during the close of the 18th century. It places supreme controlling power in the hands of the capitalist who then becomes the sole master of the house. The individuality of the working man then becomes lost in a system in which

he is nothing more or less than a chattel in the hands of the employer.

This whole attitude rather than exalting Christian principles as are taught in the Bible completely negates the whole character of love which Jesus established in His life and attitude towards man.

It is time the leaders of the CLAC set about reforming their own stand rather than thinking about reformation in the field of labour legislation. Then they would be welcomed to the rank and file of the Christian Trade Unions of Canada which takes its positive stand on Christian principles.

Bill Graham.

This article says: Any union which does not oppose an employer as an antagonist gives evidence of a "basic moral irresponsibility to society"; and such failure to oppose an employer as an adversary "negates the whole character of love which Jesus established in His life and attitude towards man." Unless you oppose your employer vigorously — resist him — you are not following the message of Jesus regarding love.

FIRST PRINCIPLES believes this pugnacious and bellicose attitude of individuals in the Christian Trade Unions of Canada stems from a misunderstanding of the Hebrew-Christian Scriptures, and also a lack of understanding of the economic structure and functioning of society. Employes are not enemies of the employer; nor are employers enemies of the employee.

## **Economics, The Science To Make "Selfishness" Efficient**

Economics works on the problem of showing the best way to allocate the economic goods which are in short supply.

Every effort to get the most for the least is promoting self-welfare. Every effort to spend money wisely is a manner of seeking self-welfare. Every effort of a businessman to endeavor to be more efficient — to eliminate unnecessary work, to use time-studies, to sell more but to reduce costs — is the pursuit of self-welfare. These are the problems with which economics concerns itself. And so, if it is assumed that the promotion of self-welfare is bad — a missing of the high mark we should attain, namely, altruism — then economics is the science of showing how to sin most efficiently.

A friend is the president of a large business. He is also the clerk of the Session in a Presbyterian church. (The Session of a Presbyterian church is its ruling body.)

In ordinary conversation, this friend manifested astonishment and disappointment when he discovered that I considered selfishness a natural phenomena — and *not* sinful. He admonished me that selfishness should not be permitted to enter into my plans. This took place in the morning.

In the afternoon we attended a directors' meeting. He was chairman. In the meeting three hours were devoted to self-welfare — to increase sales, reduce costs, increase profits. The motivation to increase sales was selfish — to make the company more successful. The motivation to reduce costs was selfish — so that prices could be lowered and more volume in units could be obtained. The motivation to increase profits was equally selfish — to have the means to expand the business, to retain his position as president, and increase dividends to members of his family who are large stockholders. Here was a businessman endeavoring to be efficient, to accomplish the most for the least, and he considered that to be a virtue, and a benefaction to all his fellows.

In the morning this businessman, in the abstract, was preaching that concern for self-welfare was wrong. In the afternoon he was earnestly working at nothing else than self-welfare (of a wholly legitimate kind).

There is often a peculiar dualism — inconsistency — in people's ideas. In church they talk one way. In business they talk another way. Actually, they act as they talk in business, and they do not act as they talk in church, which is something for which to be thankful.

The world is full of split personalities — people who talk about the unattractiveness of promoting self-welfare, but who act basically on that principle — and wisely so.

\* \* \*

But, some social gospeller may say, it is not the efficient conduct of men in regard to things to which we object, but there is a later phase in the operation which we condemn. Men work in an organism, namely, in the markets of society, in order to increase production, obviously for purposes of self-welfare. That is all right. But the "trouble" comes later. The "distribution" to each participant of his share in the proceeds of the joint effort may not be — in fact, is not — equitable. Injustice in the rewards — that is the phase of the situation to which we object.



That is a radical shift. Now altruism as a principle has been relinquished, and the pursuit of self-welfare is tacitly approved, by this change of front.

Now, on what must the evidence of injustice be based? Can it properly be anything else than that in the division of the proceeds of joint effort there has been either coercion, falsehood or theft? If there has been injustice, all that needs to be proved is that one or more of these sins has been perpetrated.

The social gospel is not willing to leave unaltered the distribution of proceeds resulting from relying on the principles of meekness, honesty, and truthfulness. It demands something else beyond that. No, not voluntary charity. Even after that is added, "justice" will not have been attained, according to the social gospel.

*Maybe if the process by which economic goods are "distributed" to various people is thoroughly explained, then the ideas of the social gossellers will be modified in the direction of realism.*

## Neither God Nor Man Arbitrarily Legislated Ownership Of Property

It is alleged by Marxian socialists, and accepted by many social gossellers and orthodox Christians, that ownership of property is a mere legal creation, an arbitrary act of men. The institution of private property, according to this doctrine, is not "in the nature of things" but a *human* institution, an evil one at that, and it is asserted that men *can* and *should* change it.

It can also be argued, as by the writer in *The Voice*, quoted earlier, that God did not legislate ownership of property either.

An atheist might argue that the God of the Christians was as *arbitrary* about legislating to authorize ownership of property as men are (allegedly) arbitrary in legislating to authorize ownership of property. Such legislation by God in favor of ownership of property would appear to be equally capricious as the same act by men. The idea might be that He could as well have legislated differently.

And so, whether the origin of ownership of property is the law of man or of God, the institution of the ownership of property *could be done away with*.

A better view, it is believed, is that ownership of property really rests *in the nature of Creation*, and antedates legislation by

God or men in favor of ownership of property. Under this view God was simply consistent with Himself when He *legislated* ownership of property, because He had previously created circumstances which required ownership of property, if activity under those circumstances was to work harmoniously and advantageously. Under this view, ownership of property is genuinely "in the nature of things."

On this subject we quote extensively from Menger's *Principles of Economics* (*op. cit.*, pages 96-98).

... if the requirements of a society for a good are larger than its available quantity), it is impossible, in accordance with what was said earlier, for the respective needs of all individuals composing the society to be completely satisfied. On the contrary, nothing is more certain than that the needs of some members of this society will be satisfied either not at all or, at any rate, only in an incomplete fashion. Here human self-interest finds an incentive to make itself felt, and where the available quantity does not suffice for all, every individual will attempt to secure his own requirements as completely as possible to the exclusion of others.

In this struggle, the various individuals will attain very different degrees of success. But whatever the manner in which goods subject to this quantitative relationship are divided, the requirements of some members of the society will not be met at all, or will be met only incompletely. These persons will therefore have interests opposed to those of the present possessors with respect to each portion of the available quantity of goods. But with this opposition of interest, it becomes necessary for society to protect the various individuals in the possession of goods subject to this relationship against all possible acts of force. In this way, then, we arrive at the economic origin of our present legal order, and especially of the so-called *protection of ownership*, the basis of property.

Thus human economy and property have a joint economic origin since both have, as the ultimate reason for their existence, the fact that goods exist whose available quantities are smaller than the requirements of men. Property, therefore, like human economy, is not an arbitrary invention but rather the only practically possible solution of the problem that is, in the nature of things, imposed upon us by the disparity between requirements for, and available quantities of, all economic goods.

As a result, it is impossible to abolish the institution of property without removing the causes that of necessity bring it about—that is, without simultaneously increasing the available quantities of all economic goods to such an extent that the requirements of all members of society can be met completely, or without reducing the needs of men far enough to make the available goods suffice for the complete satisfaction of their needs. Without establishing such an

equilibrium between requirements and available amounts, a new social order could indeed ensure that the available quantities of economic goods would be used for the satisfaction of the needs of different persons than at present. But by such a redistribution it could never surmount the fact that there would be persons whose requirements for economic goods would either not be met at all, or met only incompletely, and against whose potential acts of force, the possessors of economic goods would have to be protected. Property, in this sense, is therefore inseparable from human economy in its social form, and all plans of social reform can reasonably be directed only toward an appropriate distribution of economic goods but never to the abolition of the institution of property itself.

The foregoing reasoning is simple but cogent. There will be a great gain in realistic thinking if the full force of the argument is understood, to wit, *that ownership of property is in the nature of things*. Such ownership *cannot* be eliminated. All that can be done is the ownership can be redistributed — taken from one and given to another — *but not abolished*.

All moral problems associated with ownership of property pertain only to who is the *rightful* owner, not to the institution itself.

## How The Economic Concept Of A "Good" Is An Einsteinian "Frame Of Reference" For Ethical Problems

Any system of ethics which begins with the problem of the relationship of men to men, and neglects the *prior* problem of the relationship of men to *economic goods*, lacks an adequate frame of reference. Such a system of ethics is afloat in a fog of unreality and abstract theory.

In 1881 the Austrian economist, Eugen von Böhm-Bawerk wrote an article with the title, *Rechte und Verhältnisse*, which can be translated (and elaborated) into an American title, *The Economic Significance of Legal Rights and Contractual Relationships*. For his purpose, at that time, it was important for Böhm-Bawerk to define accurately what he meant by a "good." He is distinguishing between a *good* and a *thing*; an *economic good* is a sub-class under *good*.

What follows is a translation of part of what he wrote in Chapter I of the work just mentioned:

I shall set down the following as the attributes necessary to goods-quality, that is to say, the qualities which are required if a thing is to merit definition as a good for an economizing

human individual. These qualities, be it noted, must be present simultaneously.

1. There must be a human *need* which the thing can serve. If there is no purpose to be achieved, there can be no means to the end; if there is no want, there can be no good.

2. The thing must be *objectively adapted* to bring about, directly or indirectly, the satisfaction of the want. Herein lies the criterion of goods-quality which most prominently attracts attention and which the layman frequently considers to be the only essential criterion. This may also be expressed by saying that a thing must possess properties which are, for man, *useful properties*. Bread must possess nutritiveness; steel must have hardness; glass must possess resistivity and transparency; ink must exhibit adhesion and color-fastness. These things must possess these qualities if they are to serve man's wants in the way of nutriment, shelter and the other respects in which his experience dictates that he relies on the things mentioned.

3. Man must *recognize and be aware of* this adaptability of the respective thing to the satisfaction of human wants. A "usefulness" that is unknown to man is of no use to him. Before man discovered its medicinal qualities, the bark of the cinchona was to him a useless thing — it was not a "good." Even though man's knowledge be no more than theoretical or fragmentary, all that is required is that his knowledge be empirically adequate. Medicines were goods from that moment on in which it was known as to the why and the wherefore of their effect upon the human organism.

4. Man must not only *be aware of* the capacity of the objectively useful thing for the satisfaction of his wants; he must also *have the power to utilize* that capacity. There must be no absence of what I should like to term "knowledge of use" or of "usability." It is, for instance, quite possible that a person may be quite conversant with the usefulness of a book or, say, a microscope. But for anyone lacking the technical knowledge of how to make use of them, both would be as completely unable to qualify as "goods" as was the bow of Odysseus for the suitors, none of whom had the strength necessary to bend it.

5. Finally, it is necessary that the thing in question be disposable or available for us. We must possess the *power of disposal* over it if we are really to command its power to satisfy our wants. Any means to our ends which we are unable to put to actual use because, let us say, of spatial considerations or because we lack the necessary power of disposal, is actually of no use to us and has no significance either for our well-being or for our economy. Gold mines on the moon, exceedingly attractive building lots situated on undiscovered South Sea islands, or a house and lot belonging to someone else are *for me* not goods.

A review of the foregoing "conditions precedent" to goods-quality reveals that these conditions are inherent less in the things themselves than in the economic subjects for whom they are or are not goods. The existence of want, the awareness of usefulness and of "usability" are matters which are completely subjective, and availability and dis-

possibility are partly so (in that they exist or do not exist, according to the situation of the economic *subject*). The possession of useful qualities is the sole purely objective requirement to be fulfilled by the thing itself. That circumstance leads us to two observations regarding the nature of goods.

The first of these — and it is something that has long been recognized — is that the goods-quality of a thing is never a purely objective matter, a quality inherent in the thing, such as the quality of being "wooden" or "iron," but that goods-quality depends on a *relationship* which must exist between the thing, on the one hand and an economic subject on the other hand. Furthermore, it may be true that the economic subject must possess completely peculiar individual qualifications.

The second of these observations — likewise something that has long been recognized — is that goods-quality can be caused and destroyed by the mere presence or absence of subjective relationships without the occurrence of any objective change whatsoever in the thing under consideration.

A further conclusion must be set down here — and this is one that is rather rarely emphasized though it is just as illuminating. That is that every good *can be a good only for those definite economic subjects* with respect to whom every one of the subjective economic "conditions precedent" is fulfilled. Only for those persons who feel or experience the particular want to the satisfaction of which a given thing is adapted; only those persons who are aware of the thing's adaptability; only those who possess the knowledge or skill necessary to use the given thing; and, finally, only those persons who possess the actual power of disposal over the thing — only for these persons is the given thing a good. But for all persons lacking the want, the required knowledge or the skill or awareness of the usability or the power or disposal (i.e., access to its availability) — for all such persons, the thing is *merely a thing*, not a good. Strictly speaking, then, one should never speak simply of goods as such, but always only of *goods for X or for Y or Z, or other specific economic subjects*. Hence determination of the goods-quality of a thing or the assignment of reasons for its possession of goods-quality will vary according to the degree to which the person making such determination or assigning such reasons succeeds in adopting the point of view of one or another economic subject. The most important difference that here comes into play is the difference between the *individual economic subject's point of view* and the *economic community's point of view*. The individual can recognize as goods only those things which are suitable for the satisfaction of the wants of that particular individual. And that is a circumstance which markedly restricts the area of things that are economic goods for the individual. On the other hand, the economic community's point of view embraces that of the sum total of all the natural economic subjects comprising the community (or nation) and treats them all as a single unified or collective economic subject. Since a community or a nation is not actually a natural entity and really consists of the totality of its members, it reacts, not as an entity, but as a collection of individual members. The community ap-

pears as an *active* economic subject to the extent that any one of its members is active; it appears as a *passive* subject to the extent that a member performs as a passive subject. With reference to the community-as-a-whole, therefore, all those things are goods which occupy the position of an economic good with reference to any single member of the community. That circumstance very considerably expands the area that lies open for a community's totality of goods as compared with the individual's.

If, in consequence, the totality of goods in an economic community is different from and larger than the totality of economic goods of a single individual, it does not by any means follow that, as a matter of economic principle, the things that are goods for the community are *different in kind* from those that are goods for the individual. It cannot, for instance, be said that certain categories of things are to be regarded as goods for one, but not for the other. It is, on the contrary, most patent that the great preponderance of those means to well-being which a community utilizes for the satisfaction of its wants must coincide exactly with the sum total of those things which constitute goods for the individual members of the community. There is a difference between goods from the point of view of the economizing individual only if one considers merely the point of view of a *single definite individual*, but not if one considers successively the viewpoint of all the individual members. Even then, whatever difference there may be is not a difference in kind, but only a *difference in volume*.

Finally, it may be said that both ordinary usage and the economist's technical language make only tacit reference to a whole community or a whole nation as being an economic subject. When it does so, as when it mentions, "production of goods," "distribution of goods," "turnover of goods," it does so without the addition of any qualifying phrase which specifies any definite economic subject. This sort of use of the term "goods" is not to be regarded as a reduction of the goods-concept to objective terms (it would merit condemnation, if it were), but must be considered a perfectly legitimate ellipsis which tacitly assumes that the listener will supply, as the economic subject involved, that totality of that nation which the speaker has in mind. However, it is always a fact (and it is important for the solution of our problem not to lose sight of this fact) that every goods-quality takes for granted the existence of a definite economic subject in whose favor the goods-quality may be invoked. Just as every good must be good "for something," so also it must be a good "for somebody."

Exact determination of the specific criteria which must characterize the concept of an economic good will at the same time furnish us with the identifying particulars which will differentiate between the characteristics that warrant the use of the term "good" in ordinary language usage and those which warrant the use of the term "good" in the strictly economic sense. The former includes things which are, to be sure, "good" but not "good means to an end." The first of these consists of "goods" which are desired, not as means to an end, *but as an end in themselves*. Pre-eminent among such things are ethical, religious and many other

kinds of "spiritual goods," such as virtue, happiness, contentment, peace of mind, and the like. The other group of goods which must be barred from inclusion in the concept of economic goods consists of those things that are termed "good" by *metaphorical speech usage*. Even at the colloquial level, our language abounds in figures of speech which attribute the quality of a good or of a means to well-being to things which are, by their very nature, incapable of functioning as a good and which can be clothed with the power so to function only by virtue of, let us say, personification or other metaphorical usage. [Note: by the term *goods in a metaphorical sense*, Böhm-Bawerk refers to legal rights and contractual relationships with which we are here not interested.]

The foregoing "specifications" of a good are simple and readily acknowledged to be determinative; in fact, they are so simple that their fundamental importance is likely to be unappreciated.

These "specifications" have the following consequences for ethical problems:

1. They are the *cause* of many ethical problems. It is the limited supply of goods which lies at the root of most of the controversies between men. If you obliterate the concept and reality of "goods," you have thereby removed the bulk of the ethical problems of the world, except those related to sex.

2. The motivation which men have to get "*goods*" is the most active factor stimulating the actions of men. If there were no "goods" to be got, then as just explained, men would be inert — for all practical purposes, equivalent to the dead.

3. The existence of "goods-qualities" is independent of sin. It is a creational phenomena, not a moral phenomena. The cosmos and men were *created* that way. They did not become that way by any Fall of Adam.

4. *Morals* enter the picture not at the "goods-character" point, but at the point where *improper means are adopted* by men in order to acquire "goods." Immorality enters only when coercion, fraud and theft are employed in order to affect the "distribution" between men of the "goods" which exist.

5. *Altruism* is defined in the dictionary as "devotion to the interest of others." The social gospel makes altruism a requisite to virtue and to brotherly love. The science of economics begins at a different point, namely, the individual's own needs, his own wants relative to "goods." Böhm-Bawerk explicitly states that

goods are not goods to him, except in the sense they are "*for me.*"

For example, modernistic surrealist paintings might be regarded as valueless by Mr. K. He will put forth no effort to obtain them, nor will he disburse any funds to buy a single surrealist painting. For *him* surrealist paintings are "valueless." But for Mr. L they may be esteemed to be of great value. What is K to do? Impose his "values" on L, and say, "You must not place value on surrealist paintings, and I (or we) shall forbid anyone to make any more surrealist paintings?" Or is L authorized to say, "My values are for me to decide. It is of no concern of yours that my values differ from yours. You strive to obtain what has value for you, and I shall strive to obtain what has value for me. Mind your own business." Or, may L impose his values on K, and say: "You will have to work in order to buy surrealist pictures whether you wish to or not, and the purchase of surrealist pictures is going to displace something that you want more. My values are to be imposed on you, and not yours on me." What does all this mean? This: *values* must essentially be personal, individual, subjective, each man's own. This is what was meant by the neoclassicists when they described their idea, as the *subjective theory of value*.

A man has only two courses: he will pursue his own values and permit others to pursue theirs which may be wholly different; or else he will impose his own values on others, and/or others will impose their values on him. The first is liberty; the second is tyranny. There is no middle position on this. Men may not know that, but then they are insufficiently analytical because they have never spelled out for themselves what Böhm-Bawerk spelled out in the quotation earlier in this article.

What is needed by religious leaders is an understanding regarding (1) what *things* are; (2) what *goods* are; (3) what is the source of *value*; (4) what is meant by the *subjective theory of value*; (5) how individualism is causally connected with liberty; and (6) how there is no relationship possible between the science of economics and the discipline of ethics except on the basis of the subjective theory of value. If the social gospel is religion, and if economics is a science, then there is no real relationship possible between that religion and that science except by agreement on the subjective theory of value.

This doctrine of *goods* does not exclude spiritual, aesthetical,



intellectual nor any other value. The *values* in economics cover every value of any man, material or immaterial. Neither do the economic ideas of *good* and *value* exclude specific manifestations of altruism, charitableness, forbearance, mercy, or neighborly assistance.

## An Analysis To Show Who Gets The "Profit" From New Automation Machines

For purposes of clarity there will be two sections to this article. The first section will answer the question, *What is Automation?*; and the second will answer the question, *Who Benefits from Automation?*

*Automation* can not be adequately understood, from an economic viewpoint, except in a proper historical perspective. That explains the inclusion of some background material which follows:

### A. What Is Automation?

An *automation machine* is a type of machine, presently relatively new, which performs automatically certain work which previously had required the direct labor of a man, or men, because the *variety* of the operations was too complicated for any then-available machine to perform.

To show where *automation* machines fit into the sequence of the factors which have improved the standard of living of mankind a sketchy summary is given of what has happened over the centuries.

1. First men were wandering berry and nut pickers, hunters and fishers; they did not labor to produce products, but only to garner what "nature" provided without man "cultivating" nature. This is the poorest and most precarious way to obtain the means for living.

2. Next, men became primitive "cultivators." They no longer "wandered." They had a fixed abode. They ploughed, planted, weeded, harvested. A primitive agricultural society came into existence. There were a few tools. Production was for the individual family. There was no "exchange." What was produced was not marketed but was consumed on the same farm. There was little division of labor except within the family. This was better than wandering berry and nut picking, without a roof over one's head, and without granaries in which to store products out-of-season.

But this was still penurious living, except by contrast with what preceded.

3. The self-sustaining family eventually gave way to an exchange economy. People began to "specialize"; when they "specialized" they produced more of what they produced than they themselves could consume; others did the same. By "specializing" they became more productive — efficient. There was more product "to go around." Each man traded his surplus for the surplus of other specialists. Money was developed to facilitate the exchange. Local "markets" developed. This was another notch higher than a "family" economy and, being better, superseded it more and more. However, "markets" were not distant, but local fairs and exchanges.

4. Next, merchants, in a real sense of the term, developed. They bought and sold in *distant* markets and were in the business of transporting that in which they dealt. These big merchants were primarily wholesalers. They were the men who went to India for spices and silks. They crossed seas in boats, and deserts in caravans. They enlarged economic "specialization" in the world. They enriched the world by making available to one climate and economy what only another climate and economy could produce. They developed credit facilities. Many merchants eventually became bankers. These merchandising-wholesaling-transporting-banking activities increased the standard of living, compared to what had previously existed. The merchant princes became what the name implies (princes in culture and wealth) because of their great services. Relative to the preceding ages, this type of economy yielded a high standard of living; relative to the present age, it was low.

5. Next, a great change occurred in *production* techniques. *Power* equipment was invented — steam engines, gas engines, electric motors. The heaviest labor could now be performed by industrial power. Steam, gas and electricity substituted for human and animal brawn. Of course, specialization increased apace. Exchanges multiplied. Markets broadened. Prosperity bounced upward. This was the Industrial Revolution; more dramatic than any of the preceding economies. Because this Industrial Revolution was so beneficial to the poor (not injurious as the pseudo-historians teach), the population increased spectacularly.

6. Then *mass* production became an outgrowth of industrial production. Business men learned of the advantages of "tooling up" in order to obtain lower costs. The first step was to standardize parts, make dies, jigs and fixtures so that a machine would almost automatically stamp or carve out the part wanted. The idea was similar to what printing did for writing. It long took more time to set type than to write in the first instance. But once the type was set, thousands of copies could be quickly run off on printing presses. "Tooling up" is equivalent to type setting in a print shop. Although it took time and money to "tool up," once a factory had been "tooled" to produce a product, it could turn that product out fast and cheaply, just as printing presses could cheaply make many copies once the type was set. Of course, this whole concept also required mass markets. Thousands had to be willing to buy the refrigerators and automobiles and the like, if the high initial expense of "tooling up" was to be justified. *Total* costs were sheared down drastically by "tooling up" and by "mass production."

7. The next wave carrying productivity forward and increasing prosperity, namely, *industrial engineering*, consisted in the effort to reduce costs by "time and motion" studies, "efficiency engineering," improved plant layouts. This development was a corollary to mass production. Saving  $\frac{1}{4}$ c per piece sounds very insignificant, but it accumulates into large sums, if the number of units totals millions, as it often does.

8. Another big surge in public welfare resulted from the discovery what organized, *systematic research*, by adequately trained research men, could do. The purpose, no matter how long distance and theoretical it might seem, was always to obtain a better or a new product for less cost. That formula is a formula which promotes human welfare, by deeds, not mere words.

9. Most recently a new "idea" has been discovered to promote the common welfare still more, namely, *automation*. The *assembly* operation (once the parts had been made by mass production and highly tooled methods) was not equally "tooled up" or mechanized. Much costly labor was still necessary to put the parts together, to do the assembly work. Indeed, much was done to reduce assembly costs by means of moving belts, hoisting equipment and similar devices, but there were no comprehensive machines

to do the whole or important segments of the assembly job. *Assembly* was a persistent stronghold of individual labor. Then smart engineers hit upon the idea of *transfer machines*. The word is descriptive, the machines transferred parts so that the parts were processed and/or assembled automatically. The operation of transfer machines is what is meant by *automation*. Automation is the latest step in the endless progress which is being made to reduce costs, and thereby make people more prosperous.

\* \* \*

Let us assume a sub-assembly for an automobile; say a *connecting rod*. Connecting rods are that part of a gas engine which connects the several pistons of an engine with the main crank shaft. Let us assume that a connecting rod consists of ten parts, such as a small shaft, three or four sets of bolts and nuts, etc. One way to put them together is by hand labor. Another way is to have a transfer machine with ten hoppers. Each hopper is kept filled with one of the parts. Each hopper is vibrated to move out parts, in the right position. Sooner or later every part moves out in just the right way onto a belt, chain or conveyor of some kind.

Let us say that the first operation required to assemble a connecting rod is to slip a bolt through a hole in the bar which is the shank of a connecting rod. By constant vibration and movement the bar and the bolt move to a position, known as position "1" where the bolt automatically slips into the shank hole. Then the two parts move on to position "2", where there is a nut waiting to be automatically screwed onto the bolt; and so on — on and on — until finally the completed sub-assembly — a connecting rod ready to be installed in an engine — vibrates off the end of the transfer machine into a container.

All that the machine needs is a few attendants to keep the hoppers full and to watch the automatic controls on the machine. Three or four men with the help of the transfer machine do the work, say, of 20 men.

### B. Who Benefits From Automation?

The transfer machine is physical capital. It did not accidentally come into existence. It had to be designed and engineered. Somebody had to provide the money to buy the material and employ the labor to put the machine together. All this had to be

done in the hope that the machine would work, and that assembly of gas engine connecting rods could be done more cheaply by using the machine than without using it. The figures used in the following illustration are arbitrary.

Let us assume that the XYZ Motor Company employs 20 men to assemble the connecting rods needed for the motors going into their automobiles. Let us say that the average cost per year per man in salary and other labor costs is \$6,000. The total cost per year to assemble the rods produced is 20 times \$6,000 or \$120,000.

Let us assume next that Henry Foote, an obscure inventor, either saves enough money so that he can take a couple of years off to design and build a machine that costs him \$60,000 or that he borrows the money from friends or bankers who themselves have "saved" so that physical capital can be formed, rather than that they consumed the \$60,000.

Let us assume that this machine when ready, with four men in attendance, can produce the connecting rods that the XYZ Motor Company needs. Further, let us assume that the machine will need \$10,000 a year for repairs, and that at the end of three years it is worn out, that is, that the machine depreciates \$20,000 a year, and is then good only for scrap. What does it now cost to produce the connecting rods?

Labor, 4 men at \$6,000	=	\$24,000
Repairs on transfer machine	=	10,000
Depreciation per year	=	20,000
		<hr/>
		\$54,000

This cost is \$54,000. That compares with the old cost of \$120,000. The saving is spectacular, \$120,000 minus \$54,000, or \$66,000.

Who gets the \$66,000 saving? *How* will it be distributed? Who should get it? Those are some of the critical questions pertaining to capitalism, and those are the critical questions pertaining to justice. And those, too, are the ethical questions, concerning which philosophers, moralists and ethical teachers concern themselves.

Let us first list everybody who could get all or part of this \$66,000. They are:

1. The inventor, *as inventor*.

2. The inventor, *as capitalist*, the man who saved \$60,000, which was used to make the machine.

3. Capitalists, who loaned the \$60,000 to the inventor, if he lacked some or all of the \$60,000 himself.

4. The mechanics who made the parts of the machine and who helped assemble it.

5. The suppliers of the raw material.

6. The XYZ Motor Company who buys the machine to assemble connecting rods.

7. The employees of the XYZ Motor Company who will operate the machine.

8. The customers of the XYZ Motor Company who will buy the company's automobiles.

9. The government who will collect more taxes.

Here are nine classes of potential claimants. All may be shouting "injustice" unless they get all or part of this \$66,000.

Progress, in the form of lowering the cost of goods wanted by customers, itself creates problems with which ethical teachers, social philosophers, capitalists, workers — indeed *everybody* — concerns himself.

How this \$66,000 should be divided can, it is believed, be explained to everybody's satisfaction *provided they do not dissent from the Law of God*, expressed in the ancient Mosaic Code which forbids coercion, fraud and theft.

1. *The Government's "Take."* The income tax collected by the Federal government of the United States from corporations is 52% of profits. If a *corporation* has by a transfer machine saved \$66,000 in its costs, then the government will get 52% of it, or \$34,320. That leaves \$31,680 for the corporation. In addition, there may be a state corporation income tax of 3% to 5% on the original \$66,000, which will bring the remainder left for the corporation below \$30,000. If individuals are involved rather than corporations, then their tax rate will depend on their total personal income. In any event, the government will get a substantial part of this basic, new saving accomplished by means of a newly invented transfer machine and automation.

That the government gets some of this makes some people unhappy, but the reasonableness of that attitude depends on what the government does with what it collects. Considering the chaotic

and dangerous character of the political situation in the world today (which the United States by its follies has done a great deal to create), it will be disastrous for the United States to be *weak* in self-defense. For any nation which is as rich as this country is, it is the acme of folly to fail to be impregnable strong.

If the government collects more than half, or in any event a large percentage of the *saving* from a new invention; and if the government spends what it collects wisely — something for which all citizens *as citizens and voters* have responsibility; then *the first benefit of the brilliance, courage and maybe self-sacrifice of the inventor*, either as inventor or capitalist (saver), has already been distributed extensively — *maybe more than half* — to the public.

(Where the ultimate incidence (impact or burden) of this tax falls is beyond the scope of this analysis. It is admitted by this writer that the burden does not primarily fall on the inventor, because the sale price of the automation machine will be increased to cover the tax, more or less. To trace that incidence here would be an unwarranted digression.)

2. *The XYZ Motor Company.* Let us assume that the inventor organized his own little company and offers to assemble connecting rods on his own transfer machine set up in his garage, his basement, or a shed built for it. What price can this little fellow get from the big motor company? The range within which the price will fall will have to be between \$120,000 as a maximum and \$54,000 as a minimum. The XYZ Motor Company will not pay \$120,000 because then it will undoubtedly keep its 120 men employed. The inventor will not sell for \$54,000, because then there is no profit in it for himself.

It is important to note that both parties approach this problem from their own viewpoint, which is determined by their own estimate of their self-welfare.

Consider what the problems are if the XYZ Motor Company is to be altruistic in this case. Altruistic to whom? to their 20 employes? or to the inventor? Here is one of the overlooked abysses of false logic. People think that altruism is always between themselves and *one* other party. The fact is that the choice they make is usually three-cornered or multi-cornered — themselves or two others, or maybe a 100 others depending how extensive competition is.

Ethical teachers often fail to get down to cases. Imagine one of them transformed into the president of the XYZ Motor Company. What will he decide on the basis of the lofty principle of altruism? Will it be for the twenty men he presently employs? If so, he hurts somebody else in exact proportion — namely, the consumers of automobiles, that is, Mr. John Public. Why? Because if the cost of automobiles can be reduced, then the price can (and certainly will under competition) be reduced. Here is still another party or parties — the consumers — deeply affected by the problem. To be altruistic to the 20 men presently employed and to retain the high cost is to be un-altruistic to consumers. The businessman has not chosen *for himself* as much as he has chosen *between others*.

There will be some who have already decided that between the lone inventor and the 20 men, the twenty (because they are more numerous) should be protected; the XYZ Motor Company man making the decision, they declare, must decide on the basis of the number of people involved. But on that principle the 20 men doing the hand assembly must not be given consideration because the 1,000,000 automobile buyers will have a better claim, if *numbers of claimants* is to be the principle.

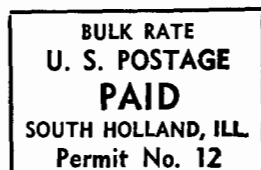
What does *altruism* turn out to be then when it is the principle allegedly employed to settle this problem morally? It turns out to be a principleless principle. It pretends that it is workable, just and brotherly, but it is a "principle" which gives no answer; it is worthless "guide." Talk; logomachy.

(To be continued.)

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## The Prayer Of A Minister Economist

If a preacher's congregational prayer on Sunday would be something like this, what would the parishioners say?

Good Lord, make us all selfish, that is, that we be unashamed about seeking our self-preservation and our self-welfare; may we always keep that in mind; may we remember what the Apostle Paul wrote:

But if any [man] provideth not for his own, and especially his own household, he hath denied the faith, and is worse than an infidel [unbeliever] (I Timothy 5:8).

May we avoid being "worse than an infidel," by providing first for ourselves and our households. May that be our main motivation.

But in doing so may we not do anything harmful to our neighbors by coercing, deceiving or defrauding them.

We pray, too, that our neighbors may be diligent in pursuing their own self-welfare and that of their families, and will generally put them first, but that they will not coerce, deceive nor defraud us.

May we *all* be truly forbearing, and manifest charity, and endeavor to educate each other in what we think is good for each. Give us the will to mind our own business, and not to endeavor to decide what others should want or have.

Teach us the wisdom to realize that we are already overburdened in attempting to be wise in the conduct of our own, specific, personal affairs. Keep us from hallucinations that we know better than others what they need, and keep others from hallucinations that they know better than we what we ourselves need. Give each of us the desire to leave the other his liberty.

Especially keep all altruism far from us, except that we be diligent in that one, valid altruism consisting in proclaiming thy gospel. May we *always* endeavor to help our neighbors in that educational, advisory manner.

This is our earnest prayer. Amen.

\* \* \*

It sounds almost sacrilegious, does it not? That it sounds that way is proof of how confused we are, and how suspicious of praying for self-welfare. We hesitate to pray that we be efficient in helping ourselves, but we plead with God to help us, as if to say, let *Him* do it.

But in this age it is an appropriate prayer, because it cuts loose from the prevailing confusion that the morality taught by the Christian religion requires *altruism*, that is, that we devote ourselves to our neighbors.

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That *heresy* of altruism in *undiluted* form is less than 100 years old. Altruism, as a *world menace and heresy* against common-sense realism and Christianity, dates from Karl Marx, who died in 1883. Marx attacked the foundations of Christian ethics, fundamentally, but he did not do that by lessening the requirements of Christian ethics. To the contrary, his method was to "extend" his own requirements beyond the requirements of Christian ethics. Instead of men being responsible for themselves, as Christian ethics has historically taught (when not being misunderstood), Marx taught that men are fully responsible for their neighbors. He taught that under the slogan, From each according to his ability to each according to his need.

This business of "extending" what morality properly requires you to do is a dangerous practice. Schopenhauer wrote in his *Art of Controversy* that the best way to get somebody else into difficulty, in an argument, is to "extend" his argument; he wrote the following under the heading of *Dialectical Strategems*:

The *Extension*: This consists in carrying your opponent's proposition beyond its natural limits; in giving it as general a signification and as wide a sense as possible, so as to exaggerate it; and, on the other hand, in giving your own proposition as restricted a sense and as narrow limits as you can, because the more general a statement becomes, the more numerous are the objections to which it is open. The defense [against a fallacy of this kind] consists in an accurate statement of the point or essential question at issue.—Arthur Schopenhauer, *The Art of Controversy and Other Posthumous Papers*, Swan Sonnenschein & Co., Ltd., London, 1896.

Whoever extends the definitely restricted scriptural teaching on *brotherly love* to mean *altruism* engages in an "extension"; he extends beyond "its natural limits" what Hebrew-Christian morality has demanded; and he has exposed himself to being shown to be foolish, because the statement has become so "general" — so "extended" — that it is indefensible.

In the days of the origin of the New Testament the basic obligations to others, when being defined, always were restricted to "not harming the neighbor." In disputations on the subject of "brotherly love" Christ asked, "How readest thou?"; and the answer He received was restricted to the not-harming-of-the-neighbor; and when He himself answered the question, He, too, *always* restricted it in the same manner, carefully avoiding any "extension."

The supplementary doctrines which Christ taught of forbearance and mercy are *not* extensions; they are consistent applications of the rules.

A minister or priest who does not know economics probably will not pray a prayer as imagined in the foregoing. But a minister who is also a good economist might at times feel impelled to pray a prayer of that kind, although he would probably feel unorthodox in doing so because of the prevailing cant.

His sermon following such a prayer might have to be devoted to explaining *why* such a prayer was not only legitimate but also necessary. Otherwise, the General Assembly of his denomination, or his Bishop, or those in authority over him, whoever they might be, might unfrock him as a man with a not-sufficiently-pious talk.

Being a Christian, and in harmony therewith proposing to act as an Individualist as Scripture really requires, the writer thinks well of the foregoing prayer, because it repudiates the spurious and sanctimonious ethics known as altruism. (Of course, the prayer is not complete; it does not cover many subjects which are properly covered in prayer; it purports to cover only one group of ethical subjects.)

## **Subjects On Which Theologians And Economists Can And Should Get Together**

"Communications" between theologians and economists can be greatly improved. Economists often do not know how to talk on morality, and may be impatient with it. Theologians often do not know how to talk on economics, and may think it has nothing to offer as a supplement to their ethics.

But the two — theologians and economists — could communicate well together, if they would undertake to understand each other's "lingo." The interchangeability of terms is as follows:

<b>Theologians' Terms</b>		<b>Economists' Terms</b>
Brotherly Love	=	Price Theory and Determination
Cosmology of		Relation of men to things or
Creation, Fall, etc.	=	goods.

Suppose a theologian and an economist ride an airplane together on a long trip, and sit next to each other. After ignoring each other for a while, and reading his own books and papers, suppose they strike up a conversation. After identifying them-

selves, each may vaguely wonder *how* he can learn something from the other and what.

The theologian will talk "revelation"; the economist will talk about the *laws of economics*, which he will consider as immutable as natural laws; added to that he will be suspicious of "miracles." The theologian will talk about "brotherly love" and will mistrust unsentimental "impersonal" transactions in the "marketplace." The economist will talk about a "free market" and will be suspicious about charity and the sentiment of "love" about which theologians talk.

But basically these men can easily find a way to be able to talk about the same thing, or else either their theology or their economics is not a serious, intellectual discipline.

\* \* \*

The "backbone" of brotherly love CANNOT be *charity*; instead it MUST be mutual *exchange*, or trade, or buying and selling; call it what you will. Charity can only *supplement* exchange. It is not the other way around that exchange or trade supplements charity.

When you talk *exchange* with a man — that is, buying or selling or trading — you are talking generalities unless and until you begin to talk *price*.

How is *price* determined? The economist, if he knows his subject, can tell something to the theologian that the latter as theologian does not know, namely, *how* price is *determined* in a *free* market. An so price determination pretty much determines "brotherly love." Right away, these two men have common ground, *if they know how to find it*.

\* \* \*

What does the theologian demand for men? He demands the "good life." He seldom means by that moral conduct *only*; he also means not only enough to live, but comforts, and even luxuries. He sees privation, hardship, toil, discouragement, inequality; then his gorge rises. He demands *more* of this world's goods for the poor, for the great mass of mankind. But the economist shrugs his shoulders, and says, "I will simply be a historian and I shall describe to you what happens in exchanges and why; I'll tell you what the realities are, and *why* people are poor, and what they must do to be less poor."

Here again there is an obvious and easy nexus between the theologian and the economist. The theologian has *his* ideas regarding the origin of the world, and why it is defective; *that* is his *cosmology*. But what the economist describes is, in turn, his cosmology.

What common thing are they talking about? Merely the actual world in which men find themselves. What can they learn from each other? They can have a common starting point; both should begin (depending, of course, in part how good the one is as a theologian and the other as an economist) with the *universal well-fareshortage*. A *finite* world hems in the *infinite* demands of men!

And so what the theologian considers important under his term, *cosmology*, the economist analyzes under the subject, the *relation of men to things*.

There should be no lack of "points of contact" between theologians and economists. They are natural allies. The "cosmology" of the theologian is the same as the "relation of men to things" of the economist. And the genuine "brotherly love" which the theologians talk about is the same thing as prudent "price determination" in a free and competitive market.

## How Economics Separates The Two Questions, Relation Of Men To Things And The Relation Of Men To Men

Economics considers questions pertaining to "the relation of men to things" under the subject of *value*.

Paralleling that, economics considers questions pertaining to "the relation of men to men" under the subject of *price*.

\* \* \*

The second item may well be examined first. The primary economic relations between men pertain to questions connected with the *exchange of goods or services*. One man produces shoes; another produces food. In how "just" or in how "brotherly" a manner they treat each other depends on how they agree or come to accept the prices used in the exchange.

If the price of the shoes is too high, the shoemaker has misdealt the farmer; if the price of food is too high, the farmer has misdealt the shoemaker. To appraise the justness (or brotherliness), of how men treat each other when exchanging, it will be

necessary to describe accurately how prices are determined in a free market. In the usual discussions about brotherly love (in the field of economic problems) by moralists and theologians, a description is seldom presented of what takes place in the price-determining process. Moralists and theologians rather freely pass judgment on a process concerning which there is evidence that they do not understand it. Factual and scientific description ought to precede appraisal and condemnation.

The complete price-determining process will require explanation in detail in later issues. Thorough analysis of the price-determining process will at the same time be thorough analyses of the questions: (1) what is right or wrong between men, (2) what is so-called justice, (3) what is so-called brotherly love. Understanding *price determination* will go a long way toward definitively answering what is or is not "brotherly love."

Someone may say that the "brotherliness" of the relations between a farmer and a shoemaker might be justly determined by simple and honorable barter, but that today the exchange is a money transaction the justness of which is not demonstrable. The use of money is a genuine convenience to facilitate exchanging or trading; money is the "most exchangeable commodity" that men know and use. But, in the *final analysis*, it is the merchandise which money represents that is being exchanged.

The use of money does not complicate exchange, but simplifies it. The use of money does not make it more difficult to appraise whether a transaction is just or unjust, but easier. Today, with the aid of money, exchanges are in general more just than in the days of primitive barter.

And so when we come to the analysis of the relations of men to men — to the analysis of brotherly love — to the analysis of something called justice — we shall go far toward accomplishing that by a thorough analysis of *price-determination*. In this we shall be following the ideas of Böhm-Bawerk, as published in his *Capital and Interest*.

\* \* \*

But price is never wisely discussed in economics until after *value* has been discussed. The analysis of value should always come first. It is under the subject of *value* that economics analyzes the earlier and more fundamental problem of the relation of men to

things. The *value* of *goods* to be *exchanged* must first be determined, in order later to arrive at the prices. Price is merely a method of expressing value, namely, in terms of the quantity of another commodity, usually (but not necessarily) money.

The greatest problem in economics is *value*. It is not sufficient to know that something is more than a *thing*, and that it is also a *good*, or is even an *economic good*. It is also necessary to know *to what extent* an economic good is an economic good, that is, whether its value is high or low. Value tells the *degree* to which something is an economic good.

If value determines price, which it should; and if price determines justice between men, which it does; then, in the final analysis, justice depends on how the relation of men to things is determined, and so it becomes apparent that the relation of men to things is after all the Einsteinian "frame of reference" for morality.

The other factor, somewhat secondary, the relation of men to men via price, will affect justice when men misconduct themselves, but there is a *basic* prior determination of value, which is the value arrived at because of economic laws affecting the relation of men to things.

What determines *value*? As in the case of the determination of price, moralists and theologians, who write lengthily on justice and brotherly love, have not (to the writer's knowledge) acquainted themselves adequately with *how value is determined in the economic process*. Here again appraisal and condemnation have been expressed without first *describing* what happens in the value-determining process.

\* \* \*

We are not Positivists who believe that science is merely description, but neither do we aim to be obscurantists. It is our belief that theologians and moralists can greatly improve their ethical teaching for the modern, complex society in which we live, if they will make a "more-scientific" approach, that is, if they will begin first with genuinely endeavoring to understand the *value-forming* and the *price-determining* process. For a theologian to appraise the exchanges between men without first understanding them is rank obscurantism.



## Things, Goods, Free Goods, Economic Goods

Economics is a science which is easy to understand if the early steps taken to master it are careful and thorough; but if not, then there can not be much hope of progress in the science.

Consideration will be given to four simple terms. It is *necessary* to distinguish carefully between them. They are: (1) things; (2) goods; (3) free goods; and (4) economic goods.

1. *Things* are just things — stones, trees, houses, money, horses, men, words—any object, every kind of thing, from sun, stars, planets to marbles. *Things* is an all inclusive term for the objects in the universe.

2. Some things are more than *things*; they are *goods* also. *Goods* are things that possess usefulness for a man or men. If there were no men in the world, there would be no goods in the world. Things can be goods as well as things, but *only if there is some relation, direct or indirect, to a person* — some need for that thing on the part of the person. That relationship must have the character of usefulness, which must be known to that person, and must be available to and potentially disposable by that person. The various requirements of a *good* were given in detail in the previous issue, in a quotation from Böhm-Bawerk's *The Economic Significance of Legal Rights and Contractual Relationships*. See pages 83-87 in the March issue. The definition there given stressed the *subjective* relationship of a person to a thing, in order to qualify it as a good.

3. Goods are of two kinds, *free goods* and *economic goods*. Free goods are things useful to men which are so abundant that they are *free*, that is, that they have no value. Although they are useful, men do not work to get them; men do not economize them; men neither buy nor sell them; in fact, they *cannot* be bought or sold because by definition they are *free* — valueless and costless. There are more free goods in the world than economic goods. Fresh air, in the great outdoors, is a free good. Free goods require a more extensive consideration, which will be given later in this issue.

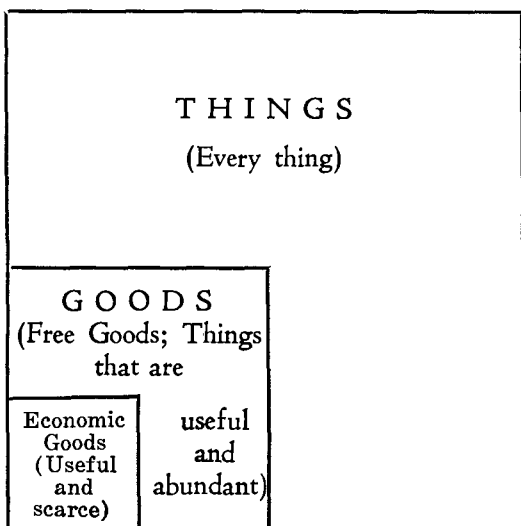
4. The fourth classification is *economic goods*. Economic goods are things which are useful to men and needed by them, *and scarce*. This class is the smallest. It is an inconsequential fraction of things, and it is a group of modest size compared to free goods.

Economic goods have *value* which they possess *because* they are scarce as well as useful to men. Men work to get economic goods; they economize on economic goods; they exchange economic goods "for value received." Men do not think of economic goods in the abstract nor as a whole class, but as specific goods, such as sugar or shoes, and not only that, men think in terms of a particular unit of sugar, as a pound, or a bag, or a teaspoonful, and of a pair of shoes. Economics teaches that men do not, if they think clearly, think of species or aggregates, but of specific exemplars of an economic good, and it is the specific exemplars which they value, not the class as a whole.

The character of economic goods needs the most careful examination. The whole science of economics pertains to economic goods. Much additional space will be devoted to considering economic goods, because it is economic goods which constitute the "frame of reference" in which the drama of morality, and ethical conduct, and justice, play out their roles.

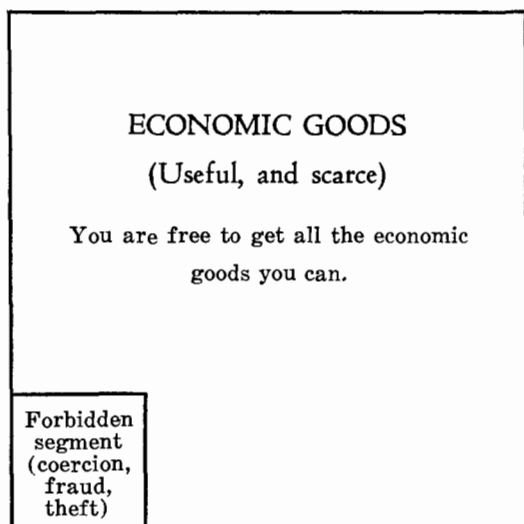
The following two diagrams show how *things* are the frame of reference for goods, how goods are the frame of reference for free goods and economic goods, and how economic goods are the frame of reference for morality.

Chart I



There is no moral restraint on men in regard to things, which are not goods; the world of things outside of goods is unrestricted to all men. There is no moral restraint on men either in regard to free goods; they are unrestricted to all men. There is also no moral restraint on men in regard to economic goods; men are free to acquire and possess them (according to the morality of the Christian religion) *provided such goods are not acquired by coercion, fraud, or theft*. If the small area of Economic Goods in the lower left hand corner of Chart I is enlarged to show what segment is restricted *morally*, then we get the picture shown in Chart II.

Chart II



The field of morality and sin is not properly a large area. Goods are only a part of things; economic goods are only a part of goods; and moral conduct pertains only to certain forbidden actions in regard to economic goods. There is ample room for magnificent freedom; immoral conduct is such a large, pervasive segment of life because of our perverse nature, our folly, and our malice; it has certainly not come into existence because it is *necessary*. Men are inclined to endeavor to promote their self-welfare by overworking the area of coercion, theft and fraud. They are threshing out the chaff and weeds of life, when the rich grain is in

the ample area of freedom where coercion, fraud and theft are eschewed.

It is not sin to want economic goods; they enrich a man's life. It is only sin to endeavor to *acquire* economic goods *wrongly*; (further, a man misses his mark in life — sins — if he overvalues economic goods and neglects spiritual goods.) The field of "economic goods" (although a small area in the total world in which we live) is an ample field for activity without sin, despite the fact that it is an area of scarcity (which means rival claims to what is scarce), if men would only eschew coercion, fraud and theft.

However, even though there were no coercion, fraud and theft perpetrated in the area of economic goods, there would still be a very significant *form of coercion*, namely, the *pressure of scarcity*. But that is a coercion which must be excluded from the area of morality, because it is not caused by the *conduct* of men, but only by their *needs* and the *scarcity of economic goods*. This type of coercion, which cannot possibly be "moral" in character, needs careful explanation, because it is constantly being confused with coercion which *is* contrary to moral law, as formulated in the Hebrew-Christian scriptures.

## Goods Move Back And Forth From Free Goods To Economic Goods, And From Goods To Things

At a given moment, under given circumstances, in a given place, there is no difficulty to classify a thing as a free good or an economic good, if it is a good at all. But in the next instant, under altered circumstances, or in a different place, that same good may be an economic good although it was formerly a free good, and vice versa.

In a waterless desert inhabited by Bedouins water will not be a free good; it will be an economic good for the members of a tribe, and will not be wasted. In a mountain valley of Colorado, where there may be a seemingly never-failing stream of pure water, that water may be a free good to some settler. In Colorado the water rushes by and no attempt is made to catch much of it; most of it is permitted to "go to waste" at that location.

But suppose there is an earthquake in Colorado, and the stream is reduced to a mere trickle. Suddenly, the farmer lacks water for himself, his family, and his livestock. His supply of

water has changed from super-abundance to scarcity. The free good has suddenly become a scarce good, and therefore an economic good.

But even in the desert water can become a mere "thing", completely neglected and wasted. All that is required to accomplish that is that all the people move out of the desert. The water in the desert, on which life would depend if human beings lived there, is suddenly "wasted." It is not gathered; it is not conserved. It has deteriorated from being an economic good to not even being a good. It has become a mere thing.

Good, in an economic sense, is relative. For one, it must be *relative to a human being*. If there were no human beings, there would be no economic good whatever; even life-giving water is not a good in the desert if there are no people in the desert. Furthermore, a *good* (in an economic sense) depends not only on a person, but on circumstances, on *relative quantities* relative to *relative demand*.

## Cosmological Good, Moral Good, Economic Good

The three kinds of good — cosmological good, moral good, and economic good — have little relationship to each other, except that the first provides a framework for the others.

*Cosmological good* is simply that the world was well created (Genesis 1:31a).

*Moral good* is simply action in harmony with the Second Table of the Decalogue, the main features of which prohibit injuring others. It establishes a *cooperative* or *contract* society rather than a coercive society. It pertains to men's relations with men.

*Economic good* is simply what is useful and scarce, and consequently difficult to acquire. It pertains to the relations of men to goods.

A little reflection will show that *good* in economics has no reference to *good* in morals. A good in economics refers to a relationship between a thing that is useful and scarce on the one hand and a human being on the other. A good in morals means a restraint in conduct between two human beings (no coercion, fraud, theft), ample forbearance, some charitableness, and unlimited good will in educating each other.

Reflection will also reveal that there is an almost contrary

relation between an economic good and a cosmological good. The world as created was declared to be a fine mechanism, which it certainly appears to be. But that attribute of being good cosmologically has limited reference to being good in an economic sense. For something to be a good in an economic sense, it almost has to be bad in a cosmological sense, because to be a good in an economic sense means to be in short supply relative to demand, and to be a good in a cosmological sense would usually be taken to mean to be in ample supply.

Although the world was well constructed, it does not yield men everything that they want without strenuous effort on their part. In fact, if men wish a really comfortable life, they are obliged to work hard and wisely. Economic good is the product of that strenuous effort by men. Economic good consists mostly of the alterations made by men in natural objects in order to make them useful or more useful to men.

The bulk of capital, or property (whether owned privately or publicly) consists of man-made economic good, that is, good which will satisfy a human need that would have to go unsatisfied, if that capital or property had not been saved and/or fabricated.

God obviously had less to do, in any *direct* sense, with economic good than with cosmological good and moral good. It sounds inappropriate for the writer of the article quoted in the preceding issue (pages 72ff.) to write: "... private property is a gift of God." If it is alleged to be a *gift* of God, there can nevertheless be no question that *men worked for it*. What men call economic good is almost entirely what men have altered and improved by self-denial and labor, not what God *gave* (except in a general sense as a *potentiality* residing in the cosmological creation). Whatever potentiality the cosmos has, it takes men to bring it forth.

The writer of the article quoted from *The Voice* represents a slanted viewpoint. If it is proper to describe private property as a *gift* from God, it is equally proper to describe wages as a gift from God. The fact is that wages according to common sense are not a gift from God, but a reward for production.

It is unprofitable to confuse *gifts* from God with the results of the labor and/or the self-restraint of men.

There is a proper time to be "earthly" in our thinking, and to forbear talking about "*gifts* from God."

## **Subjective Value, Objective Value, And Objective Exchange Value**

The term, value, has many meanings in the various phases of life. It has two important and distinct meanings in economics, to wit, *subjective value*, and *objective exchange value*. In addition, there is a third meaning, designated as *objective value*, which although related must be excluded in large part from economics. Unless these terms and their meanings are understood, further understanding of *value* and *price* in economics will be handicapped.

It will be helpful to contrast, first, subjective value and objective value.

*Subjective value* is the well-being which a quantity of an economic good possesses for a particular person, or subject. The subjective value that an apple has for you is that it will contribute to your well-being by reducing your hunger and by giving your body needed calories and vitamins. The apple has a *subjective value* for you.

*Objective value* depends on a mechanical, chemical or other characteristic possessed by something so that it is capable of participating in some change or exchange, or be an equivalent. For example, a gallon of gasoline may under appropriate circumstances propel a car forward for 16 miles. That gallon of gas has an objective value capable of accomplishing that. In this case, the comparison is between two external facts, not a comparison between a person's need and a means to satisfy that personal need. Economics has no direct interest in objective value in mechanical, chemical, physical comparisons. However, there is one, specific kind of objective value which is of the greatest importance for economics, namely, *objective exchange value*.

*Objective exchange value* is the power in exchange which one commodity has when exchanged for another, for example, two hours of labor in exchange for a dinner; or a month's rent in exchange for the right to occupy a house for a month; or \$3,000 in exchange for an automobile. These are *exchanges* where two objective things are transferred. The transaction involves objective values in a trade or sale. For example, the *objective exchange value* of a pair of shoes, in terms of United States money, might be \$20. The objective exchange value of that same pair of shoes, in terms

of labor, might be one day of labor working in a harvest field. Objective exchange value is essentially another term for *price*, usually in terms of money, but permissibly in terms of any other product available and wanted in exchange.

Even though altogether different, both *subjective value* and *objective exchange value* are of the greatest importance in economics. The former is vital to an understanding of the very existence of value in economics, and the latter is the center of the problems of pricing, exchanging, marketing.

Böhm-Bawerk has the following to say about *subjective value*, *objective value*, and *objective exchange value*. The ideas are simple enough; but it is important to learn the terminology and become accustomed to the nomenclature. The quotations are from *Positive Theory of Capital*, Book III, Part A, Chapter I, pages 121-124:

#### The Two Concepts Of Value

The concept of value does not belong solely to the science of economics. That particular sort of recognition which we call valuation is something we accord in the most varied fields of human activity. We speak of the value of virtue, of life, of health, or we prize the artistic or literary value of some product of the mind. The word is as frequently used in such connections as in speaking of the value of a commodity or a piece of real estate.

\* \* \*

#### Subjective Value

In the last analysis, the value of all goods is bound up with man and his purposes. Now the position which man takes toward a given purpose determines whether or not in ordinary parlance he ascribes value to a particular good. And that position may be either of two kinds and on its kind is based the familiar distinction between value in its subjective sense and value in the objective sense. *In its subjective sense value denotes the significance which a good or a quantity of goods possesses for the well-being of a certain subject. . . .* By this I mean that possession of the good satisfies some want, provides some gratification, affords some pleasure . . . which I should be forced to forgo . . . if I did not possess the good. In that case the presence of the good means a gain for my well-being, the loss of the good means a corresponding loss. The good has importance to me, it has value for me.

#### Objective Value

The other kind of value is objective. It signifies our estimate of the capacity of a good to bring about some definite extrinsic objective result. When we accord value in this sense to a good, we are limiting ourselves to an appraisal of the relationship that exists between the good and the accomplishment of some single objective purpose or result. . . . In this sense of the word we speak of the relative fuel value of wood and coal. We mean by that the varying effectiveness in bringing about warmth through the use of a unit of these two goods. We do the same in ascribing relative objective



nutritive value to different foodstuffs, fertilizing value to different manures, "combat value" to the different battleships of a navy, and so on. In all these uses of the word, value, there is excluded from the concept "value" any relation to the weal or woe of any person. . . .

#### Subjective Value and Objective Value Need Not Coincide

The profound difference in the nature of these two judgments as to value, and the difference in the factual situations on which they are based becomes manifest in several ways. One of these is the circumstance that the objective and subjective goods values do not necessarily coincide. That is to say that they need not be of the same order, and do not necessarily even coincide to the extent of each being present or absent in the presence or absence of the other. Two cords of beechwood, for instance, possess equal objective fuel value. And yet one of them may be the only fuel supply of a poor family in a hard winter and absolutely irreplaceable because of their lack of money. It will possess a far greater subjective value for the satisfaction of that family's wants than will the other cord which is owned by a millionaire. . . .

#### Objective Exchange Value

There are as many kinds of objective value as there are concrete purposes and extrinsic results which we may wish to take into account. Economic science will have little or no interest in most of them. The "combat value" which I mentioned by way of example has, I should say, nothing at all to do with economic problems, and the "nutritive value" and "fuel value" I spoke of can have very little and certainly only indirect connection with the science of economics. . . . I mentioned it and those other values purely by way of illustration. The purpose was to shed a more revealing light upon one particular kind of objective value of not dissimilar nature, but of exceedingly great importance in economic science. The value I have in mind is the *objective exchange value* of goods. *By that term we designate the objective significance of goods in exchange. Expressed in other words, exchange value means the capacity of goods, because of the nature of the facts in any given instance, to command a certain quantity of other goods as an equivalent in an exchange.* In this sense we say that a house "is worth" or "has a value of" \$30,000, that a horse "is worth" \$1,500, if in an exchange it is possible to secure \$30,000 for the house or \$1,500 for the horse. . . .

#### Importance Of Subjective Value And Objective Exchange Value

Each of the two concepts to which accepted speech usage attaches the name of "value" is called upon to play an extraordinarily important part in economic theory. Objective exchange value is one of the important results which it behooves economics to explain; subjective value belongs to the means or tools by which economics is to achieve some of its explanations. Subjective value is the *significance for our well-being* possessed under given conditions by the goods we deal with in our economy. That value must therefore inevitably constitute to a very large degree the criterion which determines our practical behavior with respect to other goods. . . .

As for objective exchange value it must be said that economic theory has always conceded . . . [that] exchange relations of goods has at all times been considered one of the

prime missions of economic science. There have even been economists who so grossly exaggerated this feature as to make it appear the one principal task of the science, and I can even remember a proposal to abolish the name "economics" and supplant it with "catallactics" — the science of exchange. Subjective value, by contrast, came into its own only much later. . . . The economic theory of value thus finds it must assume a double task. On the one hand it must develop the laws of subjective value; on the other hand it must also trace out the laws governing objective exchange value which, from the standpoint of economics, is by far the most important aspect of the matter of objective values generally.

## Nature And Origin Of Subjective Value, As Defined By Böhm-Bawerk

Because the concept of *subjective value* is fundamental in economics, a *thorough* understanding of it is necessary, and a more detailed explanation is justified. In his three-volume work, *Capital and Interest*, Böhm-Bawerk devoted a chapter to explaining subjective value, and gave it the title, "Nature and Origin of Subjective Value." Before quoting, a few introductory remarks will be helpful. Böhm-Bawerk emphasizes the following:

1. That there is little to learn about value, if you merely declare, for example, that bread as a category or kind of good has value for people. The statement is as incorrect as it is correct, but in any event is inadequate if one is to have a genuine understanding of subjective value and of what economics teaches. *Generalities* must be avoided. It is necessary to become *specific*; the question is: does a *specific* piece of bread have value for a *specific* person under *specific* circumstances and at a *specific* time? The whole framework of neoclassical economics is based on the concept of *specific* goods rather than on a class of goods in the aggregate, as might be designated by the term, bread. Neoclassical economics deal with the *divisible* parts of an economic good, and relates those divisible units to a specific person.

2. That all value *depends* on the *needs* of some person, and on what specific unit of a good will satisfy that need. The *subjective value* of some unit of a good is dependent on and is measured by the specific need of some person which that specific unit will satisfy.

3. That the subjective value of *every* economic good and of each unit of it is *different*, *variable*, and *varying*. No two pieces

of bread have the same subjective value. Every good has variable and varying value. If *one* chocolate sundae has a certain value for a vigorous college freshman, the *second* (which he can immediately consume after the first) has a lesser value, and a *third* will have even less value. No matter how Gargantuan the appetite of a college freshman for chocolate sundaes may be, there comes a point where chocolate sundaes not only have no *value* for him, but positively nauseate him, and the mere thought of *one more* will make him feel sicker. Unless the laws governing this *variableness* of value for goods which belong in the same class or category, and between all kinds of goods, are understood, there is no ground for believing that one understands the most fundamental subject in economics, *subjective value*.

In the following quotation it is necessary to read carefully and to understand thoroughly what is said about: (1) *usefulness*; (2) *indispensable condition*; and (3) the *unit of measurement*, or *quantity* of a good (*Positive Theory of Capital*, Book III, Part A, Chapter II, pages 127-133):

### Nature And Origin Of Subjective Value

#### Mere Usefulness Versus Variable Value

By their very definition all goods possess a certain relation to human well-being. But there is a greater and a lesser degree in that relation. The lesser is present when a good possesses the *capacity* to promote human well-being at all. But for the higher degree to be achieved it is necessary that a good be not only a competent cause of an enhancement in well-being, but also an *indispensable condition* of it. The gaining or the losing of the good must be the condition on which a gratification stands or falls. The richness and responsiveness so characteristic of man's language have caused the development of a special designation of each of these two degrees. We call the lesser *usefulness*, the greater *value*.

It is a real distinction. Let us attempt to make it clear as befits its fundamental importance for the whole theory of value.

One man is sitting beside a copiously flowing spring of fine drinking water. He has filled his cup, and sits watching the water flow past him in a stream that would suffice to fill 100 cups every minute. And now let us look at another man traveling across the desert. A long day's journey over the burning sands still separates him from the next oasis. He has one last single cup of water left. What is the relation, in these two cases, between the cup of water and the well-being of its possessor?

It is obvious at the first glance that the relation in the two cases is utterly dissimilar. But wherein does the dissimilarity consist? Simply in the fact that the first situation

exemplifies the lesser degree of relationship to human well-being — it exemplifies the mere usefulness. The second case exemplifies in addition the higher degree as well. The cup of water is just as truly useful in the first case as in the second, since it is capable of satisfying a want. And it is useful in exactly the same degree. For it is quite obvious that the qualities which enable it to quench thirst — its coolness, its palatableness, etc. — are not impaired in the slightest by the coincidental circumstance that the other cups of water possess the same qualities. Nor is the thirst quenching capacity of the water in the second instance in the least increased because it so happens there is no other water on hand. But with respect to the presence of the second and qualified degree of the relation to well-being [i.e., the indispensable condition], the two cases differ widely and fundamentally. We regard the first man and we know that . . . [if he does not have that particular cupful of water] he will slake it with any one of the 100 other cupfuls of water that the copious spring makes available to him every minute. If he wishes, the cupful of water with which he just happens to be quenching his thirst can be the *cause* of his satisfaction. But under no circumstances can that cupful be an *indispensable condition* thereof. That cupful of water, so far as the man's well-being is concerned, is dispensable, unimportant, a matter of indifference.

The second case is utterly different. Now we must recognize that if our traveler in the desert did not have that last cupful of water, he simply could not relieve his thirst at all. He would have to endure the tortures of an unslaked thirst, [and] might even succumb to them. This cupful of water is not merely a competent cause of the promotion of his well-being; it is an indispensable condition of it, a *conditio sine qua non*. This cupful is of consequence, it is important, it possesses significance for his well-being.

#### **Mankind's Indifference To Mere Usefulness**

It is not too much to say that the differentiation just described is one of the most fundamental and fruitful in all economics. It did not need the lens of the scholar with a mania for dissection and analysis to summon it into being. It is a vital factor in "everyman's" judgments, all the world knows it, uses it, makes it a guide for every contact with the world of goods, for intellectual estimates of their value, and also for actual day to day behavior. The practical economizing man is careless and indifferent about goods which are *merely useful*. The academic recognition of the fact that a good can be of use is incapable of arousing any effective interest concerning it when further recognition is also present that the same use can be derived without that good. From a practical point of view such goods are ciphers with respect to our well-being and we treat them accordingly. The loss of them does not cause us concern, and we make no effort to acquire them. Who will grieve over the spilling of a cup of water at the brookside, or put forth any energy to prevent the escape of a cubic yard of atmospheric air? But familiarity born of practice so sharpens the economizing eye that it perceives clearly how on this or that good depends a certain satisfaction, a particular bit of well-being, or the gratification of this or that vital desire. Then the effective interest we

take in our well-being is transferred to the good which we recognize to be a condition of that well-being. We are concerned about and we cherish our well-being as it is bound up in that good, we recognize its significance for us as *value*, and finally, we evince an anxiety, proportionate to the magnitude of that significance, to acquire the good and retain it.

#### Definition Of Value

We thus arrive at a formal definition of value. It is *the significance which a good or a complex of goods possesses for promoting the well-being of an individual*. Any addition to the definition concerning the kind of significance or the reason for that significance or importance is, strictly speaking, unnecessary. For real significance with respect to our well-being can be attained by goods in only one way. That way is for them to become an indispensable condition, a *conditio sine qua non* of some usefulness that contributes to our well-being. But I must reckon with the fact that other definitions also frequently declare value to be a "significance" or an "importance," but erroneously base it on the mere capacity for usefulness. Or they base it, in a manner which is essentially no less erroneous, on the necessity for the expenditure of costs or some such thing. And so I wish to frame my definition with indubitable exactitude by saying, "*Value is that significance which a good or a complex of goods acquires as the recognized condition of a usefulness which could not otherwise be contributed toward the well-being of an individual.*"

#### Value Depends On Scarcity

All goods have usefulness, but not all goods have value. In order that there be value, usefulness must be paired with *scarcity*. This does not mean absolute scarcity but only relative scarcity in comparison with demand for the goods of the kind in question. Let us put it more exactly. Goods acquire value when the total available supply of goods of that kind is so limited as to be insufficient to cover the demands which call for satisfaction by those goods, or so nearly insufficient that the withdrawal of the goods which it is a question of valuing, would render the supply insufficient. On the other hand, goods remain valueless when they are available in such superabundant quantity that not only are all wants covered for the satisfaction of which they are adapted, but that in addition there remains an excess of such goods and no wants for them to satisfy; furthermore, the excess must be sufficiently large so that the withdrawal of the goods which it is a question of valuing would not imperil the satisfaction of any want.

After what has been said concerning the nature of value this proposition should not be difficult to prove. The supply of available goods may be inadequate, so that some of the wants dependent on them for satisfaction must remain unsatisfied. In that case the loss of even a single specimen of that good entails the further loss of a satisfaction which would otherwise have been possible; conversely, the addition of a single specimen entails the undertaking of a satisfaction which would otherwise have had to be forgone. In a word, a certain degree of gratification or of well-being depends upon the existence of that good. The reverse is just as apparent. When there is an unqualified superfluity of any category of good, the loss of a single specimen can immediately be replaced

out of the excess and no harm is done. Nor on the other hand, does the addition of a single specimen of such good to the available supply add any usefulness, since the excess cannot, by the terms of our hypothesis find useful employment.

Let us assume for instance, that for all the purposes for which he can use water at all a farmer consumes a daily supply of 1,000 gallons. This will furnish drinking water for himself, his family and the hired help, will water his stock, and take care of washing, sluicing down, etc. The flow from the only source of water at his disposal is no more than 800 gallons a day. Obviously, the loss of even 100 gallons would mean a serious curtailment of the needs and activities of the farm. On that farm every 100 gallons constitutes a condition on which a certain group of uses depends. The same would be true if the flow from the spring were just 1,000 gallons a day. But if the spring flowed at the rate of 2,000 gallons a day there would patently be not the slightest damage to our farmer's interests if 100 gallons were lost. Since he can find useful employment for only 1,000 gallons, he must allow the other 1,000 to run off unused. If there is a loss of 100 gallons, it is replaced out of the excess, and the only effect is that the unusable excess is reduced from 1,000 to 900 gallons.

Now goods which are available only in inadequate or barely adequate supply are also the very goods which men are prompted to make it their economic purpose to acquire and retain, whereas goods that are available in superabundant supply are at the free disposition of everyone [i.e., "free goods"]. Therefore we amend our previous propositions to read as follows. "All economic goods have value, and all free goods are valueless." It must however always be borne in mind that it is only *quantitative* considerations which determine whether a good is merely capable of usefulness, or whether it is in addition a "condition precedent" of usefulness to us.

I just said all free goods are valueless. Atmospheric air and drinking water are such free goods. And yet it is obvious that we cannot live five minutes without air to breathe, nor preserve life a week without water [suitable for drinking]. Our well-being therefore is utterly dependent on those free goods. How can those two statements be reconciled?

#### How Individual Items Move From Free Goods To Economic Goods, And Vice Versa

But what here seems inconsistent is only apparently so. To reconcile the statements, it is necessary to consider a circumstance which will repeatedly engage our attention during the course of our discussion of value, and which will furnish the key to many a riddle. I refer to the fact that our valuation may result quite differently with respect to one and the same species of good, even at one time, and under identical circumstances. This variation goes hand in hand with a change between exercising a judgment of value with respect to single specimens and doing so with respect to larger quantities as a unified whole. As we shall see in the next chapter, our judgments in this respect may not merely vary, but may be directly opposed, and they may pertain not only to the degree of value but even to the presence or absence of any value at all.

Strange as this may seem at first glance, it is readily explainable on the basis of what has just been said concerning the conditions surrounding the origination of value. For value presupposes scarcity, valuelessness presupposes superabundance. Indeed, we just found it necessary to amplify the latter statement above and to say that the superabundance must be sufficiently large to permit the loss of the very goods which are being subjected to a valuation, without converting the . . . [excess supply] into an insufficiency. This supplementary statement indicates how a change in the magnitude of the unit being submitted to appraisal may bring about a variation in the judgment of value. Whether or not that variation takes place depends on the answer to just this one question. With goods of a given kind available in superabundant quantity, is the magnitude of the unit to be judged greater or smaller than the magnitude of the excess which constitutes the unusable superabundance? . . . [The answer] is easily illustrated by our example. For our farmer who needs 1,000 gallons of water daily and has 2,000 available, any unit of 100 gallons has no value at all. But a unit of 1,500 does have value. For it not only embraces the 1,000 gallons which the farmer may regard with indifference, but also 500 of those other 1,000 gallons which constitute an absolute necessity for the running of his farm. The 1,500 gallons cannot be forgone without causing an impairment of the satisfaction of wants. It is a condition of the latter.

#### **In Practical Life We Judge Cases Not Categories**

It may seem as if this results in a very dubious situation whereby man's judgments of value are deprived of any firm foundation and become entirely a matter of caprice. It may seem as if a good might arbitrarily be judged at a high or a low value, depending on the choice of a small or a large quantity of it as the unit on which to base the judgment.

Doubts of such a nature are not sound. For man cannot arbitrarily choose the unit to be valued. Certain external circumstances determine in any event whether or not there is any necessity for a valuation at all. As a rule, there is inherent in those same circumstances a compelling mandate which prescribes what quantity shall constitute the unit to be valued. If I need to buy a horse, I have no intention whatever of forming a judgment on the value of 100 horses, or of all the horses in the world, and to make that the criterion of how much I am willing to offer. I shall of course form a judgment as to the value of just one horse. In every instance there is some inherent compulsion by virtue of which we make just such an estimation of value as the concrete economic situation demands. The fact that in different situations we are able to render different judgments need not be regarded as disturbing, but rather as inevitable.

Let us imagine a miller who simultaneously receives two requests from neighbors. One asks for permission to draw a pitcher of water from the millstream; the other applies to the miller for his consent to a plan for diverting the entire course of the millstream. If with respect to the category "water" only one judgment of value were open

to the miller, he would in any event have to follow a mistaken course in one case or the other. If his estimate of water is "valuable," pure and simple, he would be forced into an utterly unnecessary refusal of the perfectly harmless drawing of one pitcherful of water. If his verdict is "valueless" without any and's, if's or but's, he would not forbid the diverting of the whole stream and would suffer greatly thereby. In real life our miller will quite rightly render two different judgments of value. He calls the one pitcherful valueless and grants permission without ado for drawing it from the stream; he calls the whole stream valuable and summarily forbids its being diverted.

A simple application of the principles just laid down leads to a solution of the apparent inconsistency in the valuation of free goods, of which we spoke a few paragraphs back. Free goods are available in utter superabundance. All smaller and partial quantities which do not exhaust the superabundance must, according to what has been said, be without value. And they are. The . . . evidence of everyday life [based on experience] proves that. On the other hand, if the total taken into consideration as a unit is so great a quantity of free goods that it embraces more than the super-abundance, or indeed, constitutes the total of all the free goods of a given category, then it is just as natural and just as much in keeping with what has been said, that value must be ascribed to this greater total. That is exactly what happens when the judgment is rendered that man cannot live without air and water. The thing that people *then* have in mind is the *totality* of all the air there is to breathe and all the water there is to drink. And thinking of . . . [that total quantity] as a unit which is present, or a unit which is absent makes it entirely logical to ascribe value to that [total] unit.

\* \* \*

#### There Is No Such Thing As Abstract Value

Earlier theories of value failed to propound any happy solution of the problem put by the facts just presented. They made the adequate accurate observation that judgment of value led to quite different results when applied to a whole category, and when exercised with respect to individual specimens. But they failed to recognize that they were dealing with a selective and specialized application of one single principle. Instead, they . . . [concluded that there were] two different kinds of value. One was an abstract categorical value which was possessed by the category as such; the other was a concrete value that was possessed by concrete specimens and partial quantities in concrete economic situations.

I consider the "abstract categorical value" a completely misbegotten creation. There simply is no such thing, insofar as value is understood to mean real significance for man on the part of goods. For any value that exists at all is concrete value. Mere membership in a category or species bestows upon goods nothing more than the possession of the objective qualities characteristic of that species, and hence possession of the *capacity for usefulness* that is peculiar to that species. But that is not enough to serve as the basis of any significance for human well-being even *in abstracto*



and with respect to some "abstract average human being." Genuine significance always presupposes that human well-being depends upon the goods in question, and that such dependence presupposes in turn, as we now know, a certain scarcity of these goods. But this last characteristic is never peculiar to a species as such; it only develops out of a situation in which the species is "scarce." In speaking of "drinking water," for instance, I cannot be certain of the correctness of any unqualified statement beyond the one that it has the capacity to quench man's thirst. But whether or not any quenching of thirst *depends on it*, is a question that is determined, even for the "abstract average human being," by the answer to another question. That question is, "Does he have a super-abundance of drinking water or not?"

In accordance with the situation prevailing in each particular instance, some drinking water has significance for man and other drinking water has not. Under those circumstances it is an impermissible generalization to maintain that all drinking water as such must have significance and possess value.

## Adam Smith's Unhelpful Remarks On Value

At the end of Chapter IV of Book I in Adam Smith's *Wealth of Nations*, he wrote:

The word *value*, it is to be observed, has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys. The one may be called "value in use," the other, "value in exchange." The things which have the greatest value in use have frequently little or no value in exchange; and on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce any thing; scarce any thing can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it.

Smith's "value in exchange" is obviously the same as the "objective exchange value" of Böhm-Bawerk.

Smith's term, "value in use," is really undefined and confused: it means *usefulness*. Mere *usefulness* or *utility*, as has been explained, does not give rise to value.

Smith uses water as an example of "value in use"; here he really refers to a *free good*, which (as used by Smith) *can* have no value. It is because Smith's "value in use" is not genuinely or correctly defined, that Smith's ideas on value were defective, and because Smith did not fathom subjective value, his theory of pricing

was also defective. On the subject of *value* he never really found the right road, but continued to wander in the wilderness.

If progress is to be made beyond Smith, it is necessary to understand *subjective value* as has been presented in the foregoing. Smith will be no help at all.

## Play On The Word, Subjective, In The Term, Subjective Value

A man who has been educated to believe in sentimental "brotherly love" will find it difficult to understand how others can have an intense hostility to altruism, and a militant preference for individualism.

Preference for individualism does not necessarily imply a lack of good will to others. The attitude of individualism usually stems from something altogether different from the will, namely, from the intellect. That can be explained, now that subjective value has been defined.

From the earlier quotations it will have become apparent that basically *value* is not and cannot be something objective, or an abstraction. It is *necessarily* subjective, and *relative to some person*.

If subjective value were something objective, trying to "evaluate" something for someone else might be feasible. But actually the valuation must ever be intensely personal, and must be specific — specific in quantity, specific in time, specific in place, specific in quality, specific in price, etc. Value depends on circumstances and relationships.

Obviously, a person can then, because he knows those specific factors, evaluate something on the basis of the subjective value of it *for himself*. Further, he *can* theoretically do it for his wife and children to whom he is very close and responsible; and then with very rapidly diminishing validity, for his brothers and sisters; his cousins, uncles and aunts; his neighbors; his fellow church members; his fellow citizens; his fellow human beings. But how many well-established wives, who feel that their position with their husbands is secure, really are ready to let their husbands set *all* values for them (the wives)? The answer is *none*. (If that is true of wives, how much more true it is for others less closely related.)

It is because of the intensely personal aspects of a man's decisions on *value* that he, if he is wise, restricts himself to decisions for himself, and leaves to others their decisions for themselves.

Altruism is fundamentally based on a man making value decisions *for others*. Individualism is fundamentally based on a man making decisions *for himself*. To make value decisions for other adults is arrogance and demeans the recipient. To limit value decisions to the self is humility, and leaves to others their proper freedom.

The very nature of subjective value points in the direction of individualism as the proper stance to take in life; it points away from altruism, and practically, by definition, condemns altruism as being a self-righteous tyranny, consisting of making subjective value decisions for others.

Understanding the meaning of *subjective* in the term, subjective value, will be equivalent to striking a death blow to anyone's propensity to being an altruist, no matter how well-intentioned.

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## An Analysis To Show Who Gets The "Profit" From New Automation Machines

*(Continued from the previous issue)*

Last month an example was presented outlining the advantages of automation machines. The saving was (arbitrarily) shown as the difference in costs between \$120,000 a year and \$54,000, or \$66,000. How will that \$66,000 be distributed among various claimants?

One claimant, it was shown, will be the United States government, as a tax collector. This claim will be valid if the taxes are raised for a valid purpose, and prudently and equitably.

We then turned to the other claimants. One, of course, is the inventor of the machine. Others are those who "put up the money." Others are the old workers who are being displaced. Others are the new workers who tend the automation machine. Others are the fabricators of the machine. Others are the suppliers of materials. And then there are the ultimate "consumers."

\* \* \*

Let us look at the most hapless group in this list, the 16 men who will be displaced, out of the 20 in total. Suppose they say: "That machine has robbed us of our livelihood as assembly men.

The earnings of the machine must support us." But then the machine should never have been built. If 20 men are to be a permanent drain on society although only 4 work, then society might as well discourage all invention, and leave everything as it is; economic progress in society will come to an end.

Progress, by the way, will not come into existence for society, *until those 16 men have found new work to do*, for which the labor was never before available. In other words, society does not make progress by inventions, but by the consequences of inventions, that is, by the *adjustments* which men then make. If new machines will not throw men out of work, then new machines should not be built. The purpose *from a social viewpoint* of all invention must be that men will then become available for making what could not previously be made, because the man power was previously lacking to make the new product.

Here we are, hard up against a problem in cosmology, the pressure of events on men. Men can choose: (1) always to be poor in a stable, unchanging society, or (2) to be shook up, now here, now there, in a dynamic, developing society. In the first case, poverty is permanent, because that is the cosmology of the world as man received it from his Creator. In the second case, prosperity will steadily increase for society as a whole, but individual members will periodically have a rough time; but in general, *all*, including the temporarily displaced persons, will be the eventual gainers.

One solution society has completely rejected, namely, that the 16 men are to be *permanently* idle. That solution is so foolish, and unjust, that nobody will "stand for it." In other words, men have enough sense to understand their cosmological circumstances and say to each other, "Friend, adjust to the circumstances, sooner or later; and the sooner, the better."

The only subject on which opinions differ is how hard — or how easy — to make it for the displaced persons. (1) One position is to let them shock absorb it themselves temporarily; (2) another position is to make the employer shock absorb the displacement temporarily; (3) the third is to make the public shock absorb the displacement temporarily by unemployment relief.

We ourselves favor the first, because then the adjustment will

be the most rapid. It is astonishing how fast disasters are remedied, *if people are made responsible for themselves and are free to act.*

The worst solution is the third; under that arrangement, men adjust most slowly.

Consider what happens when a young husband and father dies. The loss is stunning. The widow and children may feel helpless and become hopeless. But amazingly, they "get along." The reason is that people's minds are fertile regarding what to do to better themselves. Further, in case of genuine need, others put out a helping hand. In fact, people with hard hearts and critical attitudes become genuinely helpful in cases of *obvious* need.

Depending on the solution chosen, the 16 men may or may not temporarily get some of the "savings" from the new automation machine. But in this specific case, if the company which employed these men has a system known as "technological unemployment compensation," or if the state in which they live requires the payment, temporarily, of "technological unemployment benefits," then these men will *temporarily* receive some of the "profit" from this new automation machine. We are here primarily interested in the permanent benefits.

\* \* \*

It may be thought that the suppliers of raw materials are unlikely beneficiaries of the "savings" from a new invention, but they can definitely be beneficiaries. Take, for example, the meat slaughtering industry, and (forgetting about engine connecting rods) assume that a new automation machine accomplishes a big saving in some operation in livestock slaughtering, meat packing, or refrigeration. Assume further that the inventor lives in the interior of Iowa, a livestock-producing state. Assume he sells his machine to a small local packer. The packer buys it because he believes it will help him to make more money. He immediately expands. To do that he must buy more livestock. To date he has been buying, say, in a radius of 10 miles. Now he wants more livestock for slaughter, and he wishes to draw from a radius up to 30 miles. How does he induce farmers as far away as 30 miles to bring their livestock to his plant? He does that by raising his price for livestock enough higher so that they bring their livestock to him. And so the producers of the raw material (livestock), to be processed through a new invention at a saving in

cost, may get some of the "savings" or "profits" from a new invention.

Certainly, producers of livestock are, in a sense, surprising recipients of the benefits of an invention. The inventor undoubtedly had no special intention to benefit farmers. The thought of the possibility of that probably never entered his mind. How then did it happen?

1. He, the inventor, was looking out for his own self-welfare; he invented.

2. Still looking out for his own welfare, he sold his invention to another, the local meat packer, who bought because he in turn was looking out for his own self-welfare.

3. The packer, continuing to look out for his own self-welfare, offered to pay more for livestock; which induced the local farmers who were looking out for their own self-welfare to bring more livestock to this particular plant. Now, it is impossible to have two sets of prices in a livestock market; the packer will pay the same prices to the farmers in the 10-mile radius as to those in the outer belt in the 10-to-30-mile radius. To induce those in the 10-to-30-mile radius to bring in their livestock, these men needed a higher price than they could get before. But the greatest beneficiaries are those in the inner 10-mile radius, because they do not have any higher hauling costs. They pocket as *net* gain the full increase in the prices. Those in the 10-to-30-mile radius pocket as *net* gain the increase in the price, less any additional hauling costs.

4. Some of the benefit then of the invention may go to someone undertaking trucking livestock to a different destination, and/or further. The new trucker was motivated in this case by regard for his own self-welfare. He probably did not even know why or how this new business came his way.

\* \* \*

What was the mechanism that did all this "spreading" or "distribution" of the benefits of a new invention? Unalloyed regard for self-welfare. Or, if you wish, unashamed selfishness, or "individualism." It may seem paradoxical that pursuit of self-welfare will "distribute" benefits widely. The naive conclusion will always be that the pursuit of self-welfare will "hog" the benefits to one man only. That is true if that man may be coer-

cive. It is *never* true in a *free* society. *A*'s pursuit of his self-welfare is completely hedged in by the corresponding pursuit of *B*'s self-welfare by *B*, and by *C*'s, and by *D*'s, etc. In the illustration used, the inventor *A* was obliged to share with the packer, *B*, because otherwise the packer would not have bought the invention. To profit greatly from the invention *B* in turn shared with the farmers, *C*, *D*, *E*, and the rest. The farmers in turn shared with professional truckers. The truckers in turn shared with the gasoline filling station man, and so on endlessly. Every man affected was motivated by his concern for his self-welfare. His *knowledge* was limited to that. What might some filling station attendant in the village of Podonk, 28 miles from the inventor and the meat packer, know about the new invention? He probably had never heard of it. And he, presumably, to try to calculate abstractly *how much* of the benefit of that machine *he* should get? The very idea is absurd.

The whole approach to this problem is *necessarily individualistic*, that is, based on humble, local, specific, self-welfare, as each man sees it for himself. For him to approach it any other way is for him to suffer the hallucination that he has a knowledge equal to that of God.

How would an altruist solve this problem? In either of two ways: (1) by means of a god-like dictator, or (2) by perfect chaos.

(1) *The god-like dictator needed by the altruist*: One way to "spread" or "distribute" the benefits from the new invention is to have a "master mind" decide how much is to go to any of the nine claimants originally listed, including the suppliers of raw materials for the new machine, the farmers in the illustration here used. What a great man he must be to have such a master-mind! The common name, however, for the possessors of those master minds is bureaucrats. Some are high-minded men; some are rogues; some are smart; some are stupid; none gets a big salary, nor has a big income unless he has private investments or unless he accepts bribes. In regard to their being god-like in their intellects, any one is entitled to his own opinion. The probability is that their names will not take so much space in the *Encyclopedia Britannica* as does Newton's or Galileo's. But if a bureaucrat can really do the job outlined *justly* and *wisely*, he deserves more space than Newton or Galileo in the encyclopedia.

Unless the bureaucrat is god-like in his intellect and in his honesty, he is a tyrant. The only way for him to escape being a tyrant is to be as the Scriptures say God is, that is, wholly just and omniscient.

Altruism, via this course, must rely on human gods or human tyrants.

(2) *The alternative, perfect chaos, on which the altruist relies:* The second and alternative way by which the altruist can "solve" the problem of distribution is by all the people involved — inventor, packer, farmers, truckers, service station attendants, etc., etc. — deciding not for themselves but for all the others what each should get. The inventor does that for packer, farmers, etc. The packer does it for inventor, farmers, truckers, etc. The farmers do it for inventor, packer, truckers, service station men, etc. The truckers do it for inventor, packer, farmers, service station men, etc.

Of course, these men ought also to take into account the government with its tax rate; the displaced workmen, the consuming public who number in the millions; etc. *Everybody is to decide for everybody else. Nobody is to be motivated by his own self-welfare. Everybody is to be an altruist, looking out for his neighbor rather than himself.*

This second of the only two possible *practical* applications of altruism is an obvious manifestation of nonsense. The program means chaotic chaos.

This second solution may be taught in some pulpits and colleges. But in practice only the first solution is ever applied. The second *cannot* work.

Altruism, in fact, is humbug, sanctimony, obscurantism, and solemn silliness.

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

on which depend personal well-being and social health and harmony

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## The Relationship Between Brotherly Love And Price Determination

Much of the morality agitation of the time consists in exhorting us that we have more *brotherly love*.

Much of the social legislation of the time consists in endeavoring to change the *relative prices* of goods and services, and in that manner altering the terms of the exchanges between men.

*Brotherly love* and *price determination* are related. If prices are "determined" in one way, they manifest scriptural brotherly love; if they are determined in other ways, they do not manifest brotherly love.

It is necessary, then, to understand thoroughly how prices are determined. That requires knowledge of *subjective value*, of *diminishing utility*, and of *marginal utility*.

## Bohm-Bawerk, On The Missing "Middle Term"

In his article "The Austrian Economists" in the *Annals of the American Academy of Political and Social Science*, in the

January 1891 issue, Böhm-Bawerk wrote as follows about the Classical economists (Smith, Ricardo, *et al*) and the Neo-classical economists (Menger, Wieser, himself, and others):

. . . [The Neo-classical economists] are striving for a sort of "renaissance" of economic theory. The old classical theory . . . , [was] only patchwork at best. . . . It usually succeeded [in probing some distance] toward the depths. But beyond a certain depth it always, without exception, lost the clue. To be sure, the classical economists well knew to what point all their explanations must be traced—namely, *to the care of mankind for its own well-being*, which *undisturbed by the incursion of altruistic motives*, is the *ultimate motive-force* of all economic action.

But owing to a *certain circumstance* the *middle term* of [their] explanation . . . was always wrong . . . . To explain the modern economic order there is need of [explaining] two processes . . . (1) the relation of our interests to external goods: [and (2) the pursuit of] our [own] interests when they are entangled with the interests of others.

[The second of those is] difficult and involved. But [the classical economists even more] fatally underrated the difficulties of the first. They believed that as regards the relation of men to external goods, there was nothing at all to be explained, or, speaking more accurately, determined. Men need goods to supply their wants; men desire them and assign to them in respect of their utility a value in use. That is all the classical economists knew and taught in regard to *the relation of men to goods* . . .

It is a fact, however, that the relation of men to goods is by no means simple and uniform. The modern theory of *marginal utility* . . . shows that the relation between our well-being and goods is capable of *countless degrees*, and all these degrees exert a force in our efforts to obtain goods by exchange with others. Here yawns the great and fatal chasm in the classical theory; it attempts to show how we pursue our interests in relation to goods in opposition to [in competition or in rivalry with] other men, without [first] thoroughly understanding the interest itself [that is, the nature of *each man's interest in goods*].

\* \* \*

Thus, beyond a certain depth, all the explanations [of the Classical economists] degenerate into a few general commonplaces, and these are fallacious in their generalization.

\* \* \*

[The neo-classical theory of value] shows . . . that in an apparently simple thing, *the relation of man to external goods*, there is room for endless complications: that

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underneath these complications lie fixed laws, the discovery of which demands all the acumen of the investigator; . . .  
[Italics have been added.]

That important "middle term" which Böhm-Bawerk declares is critically important, what is it? His answer is that it is something in-between, such as this:

One end term:	The middle term:	The other end term:
The wants of a man, such as Jones.	?	Relation of Men to Each Other.

Böhm-Bawerk alleges that the something, which is in-between, will go far to explain the relation of men to each other.

This is the "middle term" that Böhm-Bawerk inserts:

One end term:	The middle term:	The other end term:
The wants of a man, such as Jones.	Relation of men to things, that is, value and price.	Relation of Men to Each Other; justice, brotherly love, righteousness.

In other words, justice, brotherly love and righteousness can be *understood* (as well as be accepted on faith) *only if value and price are understood*. They constitute the vital "middle term."

In other words, before a man endeavors to explain the relations of men to men he should *first* explain how each man is related to things.

## The Paradox Of Value

### I

Sometime in his life nearly everybody thinks as follows: "Bread is more valuable than diamonds; but bread is cheap and diamonds are dear. Should it not be the other way around; should not diamonds be cheap, because they are not nearly so necessary as bread; and, because bread is so necessary for welfare and even for survival in a famine, would it not be understandable if the price of bread were high?"

The error in such reasoning will be made evident in what follows in this issue.

### II

Sometime, too, in their lives, many people, especially farmers, will reason as follows: "The total value of a food crop is small if the crop is small. The price per bushel will be high, but

there are too few bushels to make the total dollar value large. For example, let us assume a crop of 500 million bushels and a price of \$4 a bushel, which totals \$2 billion. If, however, the crop is "normal", say 800 million bushels, and if the price is "fair", say \$3 a bushel, then the total value is \$2.4 billion. But if the crop is excessive and totals 1.2 billion bushels, then the price may drop to \$1 a bushel, and the total value will be only \$1.2 billion. A small crop yielded \$2 billion; a normal crop yielded \$2.4 billion; an excessive crop yielded only \$1.2 billion. Should prayer to God be: "Please spare us from having bumper crops?" Or, if one is not given to prayer, should the program be to destroy 400 million bushels, to reduce the supply from 1.2 billion bushels to only 800 million bushels, and thereby increase the dollar value of the crop from \$1.2 billion to twice as much, to wit, \$2.4 billion? A crop only two-thirds as large will yield, according to these assumptions, twice as much in dollars!

### III

The suburban town near Chicago in which FIRST PRINCIPLES is published is the "onion set" center of America. "Onion sets" are small, cherry-sized onions which are grown from seed, and which when replanted early in the next spring grow very rapidly into big onions. In regard to the profitability of growing this crop, the local theory is: in a three-year span there will be two "good years" for the producers and one bad one. The bad year is usually the year when the crop is larger than normal. The good years are those with a normal-sized crop, or a crop "on the short side." One farmer may subconsciously wish to have a big crop for himself, but hopes that other farmers will have a small crop. If the crop *in total* is small, the price will be high. But the *individual farmer*, who (in contrast to other farmers) has a large crop, will be able to multiply the high price by his own exceptionally big crop. If a man is disposed to pray for favorable effects for himself, his prayer should be: "Give my neighbors small crops, but give me a big one."

### IV

Some years ago the writer visited a retired farmer in The Netherlands. He was obviously a wise and respected man. He had been a potato farmer. In the great depression in the early 1930s the prices of potatoes had sunk very low. Nearly thirty

years later he was still complaining that the prices of potatoes had been "too low." "Nobody," he said, "could make money, at those prices."

What made those prices so low? Hard-hearted buyers? If so, why were the prices not *always* low? Buyers always bargain for low prices.

Moralists are disposed to explain the difficulty by implying or saying that somebody is doing something that is unethical. They do not analyze whether there is *some relationship of men to goods* rather than *some relationship of men to each other* which explains the "maladjustment."

V

These paradoxes—can you explain them? Why is a diamond, which has limited usefulness, dear; and why is bread, which has great usefulness, cheap? And why is a bumper crop—to be looked upon in general as a blessing—to be viewed with consternation by a farmer? How can a small crop have modest gross value; how can an average crop have good gross value; and how can a bumper crop, in excess of demand, be practically valueless?

VI

It is futile to "solve" such problems by referring to "supply and demand." Those three words are practically meaningless, to most people. The phrase is a cliché, unless one understands *subjective value*, and *diminishing utility*, and *marginal utility*.

## One Wrong Way To Endeavor To Explain The Cheapness Of Bread And The Dearness Of Diamonds

or

### The Inappropriateness Of Generalities In Economics Versus What Is Specific

Later in this issue Böhm-Bawerk will be quoted extensively. To those who are not accustomed to reading in the field of economics, the material quoted may be a little difficult, unless the major ideas in the quotation are first outlined in simplified form.

Why should something be dear? The instinctive answer is,

because it is *useful*. And so the first explanation that a person gives for value and price is relative usefulness.

Bread being more useful than diamonds, it should (so the impulsive answer goes) be priced higher than diamonds. More accurately, the proposition of most people would be as follows: Bread prices should remain low, but diamond prices are too high and should come down; that should be the price relationship of bread and diamonds *because* bread is more useful than diamonds.

There is in such reasoning a basic error which should be noted at once, to wit, the reasoning deals with *categories*. It does not deal with one piece of bread, nor with one diamond, but with bread as a type or category of food, or with diamonds as a type or category of stone.

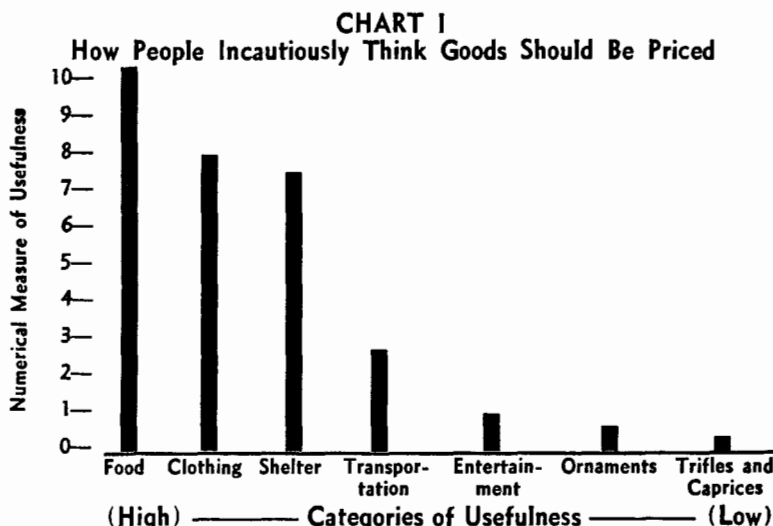
In order to make it easy to understand of just what the type of reasoning being discussed consists, Chart I is presented. The title is, "How People Incautiously Think Goods Should Be Priced." On the horizontal scale (see the bottom line), there is being shown what is being called "Categories of Usefulness." At the left hand side, there is being shown the category which has the greatest usefulness, namely, food. As the eye moves to the right, usefulness decreases. After food, comes clothing (remember Adam and Eve!); next shelter; next transportation; then entertainment; then ornaments; and finally, various trifles and caprices.

On the vertical margin, on the left hand side, there is a scale, from 0 to 10, designed to measure usefulness. Ten is taken as the maximum, and the other "usefulnesses" are in proportion.

The categories on the horizontal scale, the measures shown on the vertical scale, and the height of the several columns are all arbitrary—merely schematic.

The tallest column is for food; clothing and shelter are also shown to be important. Then there is a sharp drop to transportation, entertainment, ornaments, and trifles and caprices. Without quibbling about details, most people will agree that this chart "makes sense." From it one may conclude that food is, or should be expected to be, dear; next clothing, shelter, and so on. But regardless how simple and plausible this chart may appear to be, it is valueless and yields a false conclusion.

The reason is that it does *not* describe reality. In practical



life we do not think of food *as a category*. A sub-category under *food* is *bread*. But neither do we think of bread as a category; nor home-baked versus baker's bread; nor whole wheat versus white bread; nor the bread in the whole city of Chicago; nor the bread in a particular bakery. What we think of is *one loaf of bread*; or *one slice of bread*; or *one mouthful of bread* for ourselves. Others think the same way; they and we think in terms of the usefulness of a *specific quantity* of bread that they (we) need; (or some other food, which may be substituted for bread).

That the chart is valueless will be obvious when one thinks what is left off the chart, for example, drinking water and fresh air. Both are more useful than food. Without fresh air a man cannot live ten minutes; without drinking water a man cannot live ten days; a man can live longer than that without food. Air and water, although most useful, were not put on the chart, because they have no value under many circumstances. But according to naive reasoning, if the *usefulness* of a *category* is to be the principle that "explains," then *air* should appear farthest to the left on the chart, and should have the tallest column. Therefore, the *usefulness* of a *category* is practically meaningless in the determination of value.

The terms, *food*, *clothing*, *shelter*, *ornaments* and the rest,

are "glittering generalities." No science of economics can be built on them. The relation of men to things is too complex to be solved by talking of the relation of men to food, clothing and shelter. These terms must be reduced to a specific piece of bread, a specific article of clothing, and a specific house or something for shelter.

### The Concept Of "Diminishing Utility"

Let us assume that when thinking about economic problems we agree to abandon general terms like food, and bread; assume instead that we "get down to cases," and that we talk about Mrs. Brown's four loaves of white bread, wrapped in cellophane, of the same weight and size, bought in the same retail store, and baked by the same bakery. Are those four loaves of bread of equal value to Mrs. Brown or her family?

To that question economics gives two answers: they are equal in one sense, but they are unequal in another sense. They are equal in *objective exchange value* (as explained last month), that is, in price, but they are unequal in *subjective value*. This inequality in subjective value is of such importance, that it requires special consideration, and will hereafter always need to be kept in mind.

The subjective value of these four loaves of bread is affected by a phenomenon known as "diminishing utility."

Mrs. Brown's family of, say, four people may normally eat one loaf of bread during a meal. It could eat two loaves of bread if several other foods are eliminated. It could eat three loaves if *all* other food is removed. But the fourth loaf might be too much for the family at one meal. After eating bread only, and three loaves of it, the members are "sick" of bread; they have no appetite for the fourth loaf.

The first slice of bread for each of the hungry members of the family tasted good. The next slice tasted less good. The third slice still less good, and so on until some slice did not taste good at all.

This phenomenon of satiation, of becoming satisfied with increasing units of a good, is known as *diminishing utility*. It is a universal phenomenon. It is not only true of food; it is also true of clothes; a tenth new dress for a woman does not give her so much pleasure as the first. It is true of fine music; hear-



ing a symphony by Beethoven may entrance a listener, but if he has already sat eight hours listening to Beethoven, Bach, Brahms and Mozart, he will be weary with the sound and will welcome some quiet.

Increasing dosages of anything entail a reduction in the pleasure, and in the sense of utility, which a person enjoys. That progressive reduction in the sense of utility derived from the consumption of additional quantities of something is known as diminishing utility.

This diminishing utility was evident in the incident told in the New Testament of the changing of water into wine. The master of ceremonies, when he had sampled the new wine, called the bridegroom and admonished him that he should have served the best wine *first*. Why? Undoubtedly because the *best* wine would be *best* appreciated only when served *first*.

The ordinary man knows about diminishing utility although he may not name it. Take an obvious case: *one* automobile has a great utility for him. The *second* automobile has a reduced—a diminished—utility, compared with the first. A third automobile has an even lesser utility. There comes a time when he will not buy an additional automobile although he may have ample money for it.

In *self-conscious* thinking, people do not recognize the Law of Diminishing Utility; but in their actual calculations they unconsciously take it into account.

If you are a shirt manufacturer; if you produce more shirts than men want; if you can hardly give them away (because of their *diminishing utility* to men); and if the price of your shirts has to drop and drop and drop to match that subjective diminishing utility, then you have nobody to blame but yourself. You ought to understand *diminishing utility*. Nonrecognition of *diminishing utility* probably bankrupts more businesses than any other cause.

When you are thinking of producing more of your product, of satiating each customer some more, be forewarned that the diminishing utility of your product per person may be your undoing.

## The Concept Of Marginal Utility

The most fundamental concept in modern neoclassical economics is *marginal utility*.

The reason why marginal utility is so important is because the "marginal pairs" of buyers and sellers are the pairs that determine the prevailing market price of something. What is meant by "marginal pairs" will be explained in later issues.

*Price*, as has been repeatedly stated, pretty much determines what is equity, and justice, and brotherly love. As brotherly love and equity depend on *price*, price in turn depends on the *marginal pairs*; the marginal pairs in turn depend on *marginal utility*; and marginal utility depends on what Böhm-Bawerk calls the *indispensable condition*.

\* \* \*

Let us assume that a young miss whose father is rich has developed a consuming enthusiasm about owning a riding horse. The *utility* of a riding horse to the young lady plus the ample money supply of the doting father might result in an outrageous price being paid for a horse to someone who realized how potent a combination the young lady's enthusiasm and the father's money might be toward enabling a seller to get much more than the prevailing market price.

Or the assumption could be reversed. Assume that there is a horse enthusiast who can no longer afford the luxury of a riding horse. He is a *necessitous* seller, and he must sell *quickly*. A sharp buyer, in such a situation, might endeavor to "take advantage" of the seller, just as a sharp seller might be inclined to take advantage of the buyer in the former case.

\* . \*

But in orderly markets *extremes in prices are avoided*; that is the most wonderful thing about a "market." The so-called "free market" (by "market" is meant all the buyers and sellers and even the would-be buyers and sellers) "protects" the participants from grossly overpaying or underselling. The system works out this way: *No buyer* pays more than the marginal utility of the good for him; in fact, *all* except the marginal buyer obtain more than the marginal utility to them of what they buy. Likewise, the sellers obtain substantially more for what they sell than

they would have taken, except only the last marginal seller. Much of this will have to await further explanation in later issues.

\*            \*            \*

Let us assume that a man has an income of \$100 a week. Let us assume that 10% of this goes for taxes withheld by law. That leaves him \$90 a week of "disposable" income. How will he dispose of it?

This man has many *wants* of varying intensities. He will exchange his \$90 for what he thinks best satisfies those *wants*. He will try to maximize the gratification, which he can get by paying out his dollars and pennies in the way which yields the most satisfaction *to him*. This does not mean that he will spend all of the \$90 for himself. He may get a greater satisfaction from giving away 10% of the \$90 for charity, but he will not do that unless his *values* are of that kind. He may also *save* 5% and invest it for income to have a claim on future goods. In that case, the *value* of the saving to him is such that he prefers it to an alternative use; the *marginal utility* to him of saving \$4.50 is greater than the marginal utility of an expenditure of \$4.50.

We are down to the following—\$100 minus \$10 for taxes, = \$90, minus \$9 for charity = \$81; minus \$4.50 for saving = \$76.50 for other items. Our imaginary man will also allocate this remaining \$76.50 in a manner to get the most out of it, according to his wants and his ideas on how best to satisfy them.

What will he do? He will allot an amount for milk, gasoline, magazines, room rent, a shirt, cigarettes, musical concerts, steaks, watch repair, etc.

He will *not* deal in generalities or *categories*. He will deal with specific items and specific quantities. Every day, and every week, and every year, his allocation of his funds will change as his wants change and as his ideas on how better to satisfy his wants change. In this connection he will always take into account *diminishing utility*. Even though he is a music enthusiast, he will reach a point where he will curtail the purchase of tickets for concerts, in order to obtain another higher "utility" for him, under his specific circumstances, than the additional concert ticket will yield.

\*            \*            \*

What might another term for *marginal utility* be? The term *marginal satisfaction* has been suggested, and that may be an

even more descriptive term than marginal utility. At points in the following quotation, where *marginal utility* fails to be entirely clear, mentally substitute *marginal satisfaction*.

The economic decisions of men are designed to give them the greatest satisfaction from each of the dollars they spend. Our man with his income of \$100 a week is constantly endeavoring to maximize his satisfactions. Whenever the satisfaction he hopes to get from something falls below the satisfaction he expects to get from something else, then he turns away from the former to the latter. Marginal utility or marginal satisfaction are these borderline cases.

Men have wants. They are divisible and fractionable. Goods to satisfy those wants are equally divisible and fractionable. Problems about *value*, in the science of economics, are based on an *increment of satisfaction* dependent on an *increment of a good*. The critical, borderline cases are the instances where marginal utility and marginal satisfaction become apparent.

## Bohm-Bawerk's Chapter On "The Magnitude Of Value; The General Principle; The Law Of Marginal Utility"

*In what follows, there is a quotation in extenso of the whole third chapter of Eugen von Böhm-Bawerk's chapter on value in Volume II of his Capital and Interest. Some of the footnotes have been dropped; others have been incorporated in the text. The sub-headings have been interpolated, with the hope that they will make the reading easier.*

### Value Depends on Contribution To Personal Well-being

When we seek to establish the principle that governs the value of goods, we enter upon the field where the chief task of the theory lies, but also where we find its greatest difficulties. The latter are the result of a peculiar concentration of circumstances. On the other hand, the correct principle seems to suggest itself almost automatically. If value is the significance of goods for human well-being, and if this significance is based on the fact that some gain in well-being is dependent upon the disposition of those goods, then it is clear that the magnitude of value must be determined by the gain in well-being that depends on the good in question. A good will have a high value when an important advantage for our well-being depends on it; it will have a low value when only some trifling gain in well-being depends on it.

### The Disconcerting Paradox In Value

On the other hand, certain facts are found in the world of economics that seem to give the lie to this most obvious and natural explanation. Everyone knows that in practical economic life jewels enjoy a high valuation, goods like iron and bread have a modest value, air and water have no value at all. But everyone also knows that without air and drinking water existence would be a sheer impossibility, that bread and iron perform services that are extremely important for our well-being, whereas jewels serve primarily to meet our desire for ornamentation which, so far as human well-being is concerned, certainly has only minor significance indeed. Suppose then, that a person adhered to the principle that the magnitude of value is determined by the importance of the contributions to well-being that depend on the goods. Such a person would necessarily, it would seem, expect that jewels would have small value, bread and iron great value, water and air the highest of all. Yet the actual facts show exactly the opposite.

### Erroneous Explanations Of The Paradox

This unquestionably astonishing phenomenon became a troublesome bone of contention for the theory of value. Supreme utility and minimal value—what a strange paradox! Admittedly, one reason why the situation was neither perceived nor portrayed quite correctly lay in the prevailing confusion between usefulness and “use value.” By assigning (erroneously) a high “use value” to iron and a low one to diamonds, the causes for bewilderment were reduced to the mere circumstance that the “exchange value,” in the case of these goods, seemed to follow a principle so radically different. But that of course merely shifted the name by which the contrast was known, without altering the sharpness of the contrast itself. There was no lack of devious expedients to reconcile the awkward contradiction. They all failed. It is therefore not difficult to understand that from the days of Adam Smith down to our own, numberless theorists have despaired completely of finding the essence and the measure of value in a relation to human welfare. They therefore seized upon other and singular lines of explanation, such as labor or labor-time, production costs, “difficulty of acquisition,” “resistivity of nature toward man” and others of the sort. But since they could not entirely rid themselves of the feeling that there must be some connection between the value of the goods and their contribution to well-being, they recorded this disharmony between utility and value as a strange enigmatic paradox, a “*contradiction économique*.”

### The Ordinary Man Is Astute In His Economic Decisions

In the chapter which is to follow I shall submit proof that the early theory of value unnecessarily abandoned the most natural explanation. As a general rule, *the measure of the benefit depending on the good is really also the measure of the value of that good*. In order to be convinced of the truth of this statement, all we need to do is employ so-

ber and selective activity in our investigation of the question as to just which advantage to our well-being depends upon a good in a given situation. I say advisedly "selective activity." For actually the whole theory of *subjective value* is nothing but an extended selection as to how much depends upon a good in terms of promotion of our well-being, and when and under what circumstances that dependence manifests itself.

It is a remarkable thing that the ordinary man is erring in the selective decisions of this sort which he is called upon to make in practical life. He very rarely makes a mistake, and even then never in principle. He may be in actual error in taking a diamond to be a glass bead and in therefore assigning to it a very low value. But he will never allow himself to be misled into a selective error of judgment on the principle, say, of the value of drinking water. That is to say, the circumstance that man cannot live without water is, from the standpoint of principle, irrelevant; the common man would not be misled into the erroneous selective judgment that every quart of water he draws from the kitchen tap is therefore a treasure of immense value, and cheaply purchased at \$1,000. It will now be our task to hold the mirror, as it were, up to the practice of making *selective decisions* in everyday life, and to discover the rules that the common man instinctively applies with such utter assurance. We shall then perceive them with equal assurance, but with far greater conscious recognition.

As a general rule, whenever the promotion of our well-being depends on a good, such promotion consists in the satisfaction of a *want*. There are certain exceptions of minor importance, but we shall defer treatment of them until a later time. The correct selective decision as to how much depends on a good for the promotion of the well-being of a person really resolves itself into the answers to two complementary questions.

- 1] Which among several or numerous wants depends on a good?
- 2] How important is the dependent want, or rather its satisfaction?

For reasons of expediency let us consider the second question first.

## I

### How Important Is The Dependent Want?

#### Wants Are Graded

It is a matter of common knowledge that our wants vary widely in importance. We are in the habit of determining the degree of that importance by the gravity of the adverse consequences which ensue for our well-being when the wants are not satisfied. We therefore attach supreme importance to wants of such a nature that the failure to satisfy them would result in death. We attach the next smaller degree of importance to wants of such a nature that failure to satisfy them would entail a serious and long lasting impairment of our health, our honor, our happiness. Further down the scale are such wants as involve more transitory sorrows, pains or deprivations. At the very bot-

tom we place wants of such kind that failure to satisfy them costs no more than some very slight discomfort or renunciation of some very lightly regarded pleasure. In accordance with these characteristics it is possible to construct a progression or graduated scale of wants in point of importance. That scale will of course vary from person to person because their varying physical and intellectual propensities, amount of education and the like, will result in widely varying wants. Even the same individual will vary widely in his wants at different times. And yet every practical economizing person, if he is to make a wise choice in the application of his limited means, will have to have his scale of wants more or less clearly in mind. There have even been several theorists who have taken occasion to set up such a graduated scale on the basis of "objective" unbiased scientific considerations.

#### The Difference Between Concrete Wants And Categories Of Wants

That would all be very simple and sure, if it were not for the ambiguity inherent in the expression "the ranking of wants." The expression may mean the rank and order of *categories of wants*, or may mean *concrete wants*, that is to say, the individual feelings of want. The two graduated scales differ materially from each other. If categories of wants, taken as units, are assigned to classes with respect to their importance for human well-being, there can be no doubt that the leading class would include the need of food; in a class very little lower would be found the need of shelter and of clothing. It would be only to classes much lower that we should assign such needs as the desire for tobacco, for alcoholic beverages or for the enjoyment of music. Finally the desire for ornament and the like would be assigned to a class far lower down the scale.

Graduating concrete wants however, would lead to materially different results. For within each category of wants the individual wants are by no means equally intense and not all satisfactions are equally important. Consider, as an example, the case of a man who has not had a bite to eat for a week and who is close to starvation. The need for nourishment is inordinately more urgent than in the case of a man sitting at the dinner table, who has just completed the second course of his usual three course dinner and merely wants to eat the third as well. That modification puts an entirely different aspect on the question of ranking individual concrete wants, and introduces far greater variability. On the graduated scale for categories "need of nourishment," lumped together, was placed well ahead of need of tobacco, need of alcoholic beverages, need of ornament and so forth. But now the individual concrete wants from different categories cross each other's paths. Admittedly, the most important wants out of the most important categories will be ranked in the very forefront. But the less important wants of those categories will often be out-ranked by concrete wants from lower ranking categories. It will even happen that the last strugglers in the high categories will be of lower rank than the leaders among concrete wants of lower categories. It is analogous to com-

paring the European mountain ranges, Swiss Alps, Pyrenees, the Sudetic range, the Harz Mountains. It is one thing to rank these mountains as to altitude, taking each range as a whole; it is quite another thing to rank the individual peaks in the order of their altitude. Taken as whole ranges, the Swiss Alps outrank the Pyrenees which in turn are higher than the Sudetes, and the Harz Mountains have the lowest rank. But if the individual peaks are compared, there will be many Swiss mountain tops of a lesser altitude than some peaks in the Pyrenees, and some of them may even be outranked by one or two in the lowly Harz.

Now the question arises as to which scale to use, when we value goods, in order to determine the importance of the wants that depend on the goods. Shall we use the *scale of categories*, or the *scale of concrete wants*?

#### Value Not Properly

#### Measured By Scale Based On Categories

Arriving at this crossroads—the first that offered an opportunity for error — the older theory chose the wrong turning. It seized upon the scale of categories of wants. Now on that scale the category called “need of nourishment” occupies a very high place, the category “need of ornament” a very low rank. For that reason the old theory of value rendered a verdict that, in general, bread has a high “use value,” and jewels a very low “use value.” And then, of course, there was great astonishment at finding that in real life the estimation in which the two are held is just the reverse.

The verdict is in error. The rationalization which determines the selection must run as follows. With the one piece of bread which is in my possession I can very well assuage one or the other concrete hunger pang as it manifests itself in me. But I can never in the world satisfy the aggregate of all real and possible stirrings of hunger, all the present and future appetites which constitute the category called need of nourishment. It is therefore patently ill advised, in gauging the importance of the contribution this bread can make to my well-being, to measure it by considering whether that universal aggregate of wants is of great or small importance. It would be comparable to the act of a man who, when asked about the height of the Kahlenberg hill (part of a tiny spur of the Swiss Alps), answered by stating the height of the entire Alpine range. As a matter of actual fact, no one in practical life would even dream of revering every slice of bread he owns as a life-giving treasure of supreme importance. Neither does anyone jump for joy because for two thin dimes he has preserved his life by buying a loaf of bread at the chain-store, any more than he would condemn his neighbor for wantonly risking his life by carelessly handing out a “slice of rye” to a hobo, by squandering it, or even by feeding it to the dog! Yet those are the very things people would do, if they attached the same importance to every *specimen* as they do to the *category* “need of nourishment,” the satisfaction of which actually is a matter of life and death.

Thus it becomes clear that the valuation of goods has nothing to do with the order in which categories of goods



may be ranked, but only with the ranking of concrete wants. If full benefit is to be derived from that conclusion, a few points concerning the composition of that graduated scale of rank must be made clearer. It is especially necessary to supply a firmer foundation than the foregoing discussion has as yet furnished.

#### Wants Are Divisible Or Fractionable

Most of our wants are fractionable in the sense that they are amenable to partial satisfaction. When I am hungry, I am not faced with the alternative of being fully satiated or starving entirely. It is possible for me to assuage the worst of my hunger by partaking moderately of food, possibly to enjoy my fill later by means of a second and even a third ingestion of food, or possibly to content myself perforce by the first partial satisfaction. Such partial satisfaction of a concrete want has an importance for my well-being that is different from and smaller than that of a complete satisfaction of the same want. That circumstance alone would to a certain degree suffice for the existence of the phenomenon previously mentioned, namely that within a single category of wants individual concrete wants (including partial wants) manifest varying degrees of importance.

#### Continually Repeated Enjoyment Affords Decreasing Pleasure

But there is a further circumstance which allies itself to this one. It is a facet of human experience, as familiar as it is deep-seated in human nature, that the same act of enjoyment continually repeated, affords decreasing pleasure from a certain point on until it is finally transformed into its opposite and arouses disgust and revulsion. Everyone knows from his own experience that the fourth or fifth course of a banquet arouses far less appetite than did the first, and that as the courses continue to be served there finally comes a point where any further partaking of food is utterly repugnant. Similar sensations can arise in the course of a concert, a lecture, a walk or a game that continues for an unduly long period. This will apply, indeed, to virtually all physical and intellectual enjoyments as well. [This is known as "Gossen's Law of Diminishing Utility."]

To express the essence of these familiar facts in the technical language of economics we can formulate the proposition as follows. The concrete fractional wants into which our sensations of want are divisible, or the successive partial satisfactions which can be obtained through equal quantities of goods are usually of *differing importance, and that importance tends to diminish progressively toward zero.*

This principle explains a number of the foregoing statements which were there presented as bare assertions. In the first place we find here an explanation of the fact that within one and the same category of wants there can be concrete wants and partial wants possessing varying degrees of significance. Indeed, not only *can* such be the case but rather it *must* occur as an organically imperative phenomenon, as it were, simply for the reason that it is an obvious characteristic of fractionable wants,

which is what our wants, for the most part, are. In the second place we find here an explanation for the fact that even in the most important categories gradations of wants are represented down to lower and lower intensities of importance. The only real difference between the more important and the less important categories is that the "peaks" in the former attain higher altitudes, so to speak. The base for all the categories is at the same level. And finally we find here an explanation for one fact which is not merely a *possibility*, as we said above, but rather a regular, usual and organically inevitable phenomenon. I refer to the circumstance that although a category may, on the whole, occupy a very high position in the scale of comparative importance, some individual concrete want within the category may be outranked by some individual concrete want in a category that, on the whole, occupies a lower position on that same scale. There will at all times be innumerable wants of nourishment that are less intense and less important than some concrete wants in quite unimportant categories such as the needs for ornament, for attendance at dances, for tobacco, for making pets of song birds and the like.

#### Classifications Of Wants Both By Categories And Intensities

If we attempt to illustrate the classification of our wants by a typical schematic arrangement, we should on the basis of what has just been said arrive at something like the following.

Importance Of Categories On A Descending Scale										
Importance Of Fractional Amounts On A Descending Scale	I	II	III	IV	V	VI	VII	VIII	IX	X
	10	—	—	—	—	—	—	—	—	—
	9	9	—	—	—	—	—	—	—	—
	8	8	8	—	—	—	—	—	—	—
	7	7	7	7	—	—	—	—	—	—
	6	6	6	—	6	—	—	—	—	—
	5	5	5	—	5	5	—	—	—	—
	4	4	4	4	4	4	4	—	—	—
	3	3	3	—	3	3	—	3	—	—
	2	2	2	—	2	2	—	2	2	—
	1	1	1	1	1	1	—	1	1	1
	0	0	0	0	0	0	0	0	0	0

In the foregoing schematic arrangement the Roman numerals I to X denote the various categories of wants and their rank in descending order. Number I represents the most important category of wants—let us say, want of nourishment. Number V represents some category of medium importance—let us say, the desire for alcoholic beverages, while X represents the category of wants possessing the smallest conceivable importance.

The Arabic figures 1 to 10 then represent the concrete wants and partial wants that occur in the various categories. The figure itself indicates the relative ranking of the concrete wants in question, the rank 10 designating a want of the greatest conceivable importance, the rank of 9 designating a want of the next greatest importance, and so on down to 1 which represents a want that has the least

importance that will account for its existing at all.

The table enables us to visualize the fact that the more important the category, the greater is the maximum importance that any concrete want within the category may attain.

But it also illustrates that in addition all lesser degrees of importance are represented right down to the vanishing point. Categories IV and VII are exceptions to this rule in that certain gradations in the descending order are missing. These illustrate those infrequent categories in which for technical reasons successive satisfying of partial wants is either partly or entirely impracticable, that is to say, where the satisfaction of wants must take place completely or not at all. The need for a device for heating my dwelling, for instance, is so completely satisfied by *one* furnace that I should simply have no use at all for a second.

There is a third and final point to be visualized by means of our table. In the most important category, Number I, concrete wants occur with the minimum ranking of 1, while at the same time in almost all categories of lesser importance than I, there are concrete wants with a rank in excess of 1.

To correct misunderstandings which have arisen despite my precautions, I should like to state explicitly that the descending scale represented by the Arabic numerals 10 to 1 in this table do not symbolize anything beyond the fact that each concrete want designated by a given number has a lower intensity or importance than any want or wants designated by a higher number or numbers. The series of numbers is not meant to convey the *degree* to which the importance of a want with a higher index exceeds that of a want with a lower index. It is *not* by any means my intention to make the statement that a want with an index of 6 is exactly three times as important as one with an index of 2, nor that one with an index of 9 possesses an importance exactly equal to that of wants with indices of 6 and 3 combined. [This paragraph was originally a footnote.]

## II Which Among Several Or Numerous Wants Depends On A Good?

Let us now turn to the other one (the first) of the two principal questions propounded on page 142 of this section. That question reads: *Which among several or numerous wants depends on a good?*

This question could not arise, if conditions in economic life were so simple that each single want corresponded to a single good. If a good is suitable for the satisfaction of just one single concrete want and if it is at the same time the only one of its kind, or at least the only one available, then it would be clear without any deliberation that on the power to dispose of that lone good depended the satisfaction of the only need which the good is capable of serving.

But in actual practice the matter is almost never so simple as that. On the contrary, it is usually very complicated in two directions. In the first place, one and the

same good is ordinarily suitable for use in satisfying several concrete wants, which also exhibit varying degrees of importance. And in the second place there are often numerous specimens of the same kind of good available, and so it is the result of purely arbitrary choice that one specimen is used to satisfy an important want, and another to meet an unimportant need. Let us adduce as simple an example as possible. I am on a hunting expedition and the only food I have with me is two completely identical loaves of bread. I need one to satisfy my own hunger and the other to feed my dog. It is quite clear that my own nourishment is far more important to me than that of my dog. It is just as clear that I can make an arbitrary choice as to which of the two loaves I want to eat myself and which I will feed to my dog. And now the question arises, "Which of the two wants here depends on my bread?"

**Identical Goods In Identical  
Situations Have Identical  
Values, Although Used Differently**

One could be easily tempted to answer by saying it is the want which the loaf in question was actually intended to satisfy. But it is easy to see immediately that such a decision would be erroneous. For it would mean that the two loaves, since they are destined for the satisfaction of wants of differing importance must also themselves differ in value. At the same time it is beyond question that two identical goods, available in identical situations must also be absolutely identical in value.

Here again some simple selective rationalizing leads to the desired goal. The simplest way to determine which one of several wants depends on a good is to observe which want would fail of satisfaction if the good which is to be valued were not present. That need is obviously the dependent one. *And now it becomes easily demonstrable that the choice does not fall at all on the want which its owner's arbitrary option had selected. It will always fall on the least important among all the wants concerned, that is to say, among all the wants which would otherwise have been provided for through the total supply of goods of that kind, including the specimen to be valued.* [Italics added.]

**Wants Are Ranked  
Or Graded**

Regard for his own advantage, as obvious as it is compelling, will induce every reasonable economizing person to maintain a certain fixed order of precedence in satisfying his wants. No one will be so foolish as to expend all the means available to him on the satisfaction of trifling and easily dispensable wants, only to leave necessities unprovided for. Rather will it be every man's purpose to employ the means available to him for his most important wants to begin with. He will then go on to the next most important, proceed to wants of third rank and continue in such manner that the wants of a lower rank will not be selected for satisfaction until all wants in higher grades have been met, and as long as means of further satisfaction are available.

These obviously reasonable rules are adhered to even when the previous supply suffers diminution by the loss of one specimen. This of course disturbs the plan of expenditure followed up to that point. Not all the wants which had previously been scheduled for satisfaction can now be covered, and a diminution in the number of satisfactions is inevitable. But the reasonable economizing subject will of course attempt to have the diminution strike at the least sensitive spot. That means that if the loss happens to involve a good that was intended for a more important disposition, he will not forgo satisfying the more important need and obstinately cling to the former plan of satisfying needs of minor importance. Instead he will in any event satisfy the more important need and leave uncovered the want which, among all the wants previously slated for satisfaction, he regards most lightly.

Let us return to the example we were last discussing. If the hunter loses the loaf which he had intended for his own lunch, he will never expose himself to the risk of starvation and feed his one remaining loaf to the dog. He will on the contrary make a quick change in his plans for the disposition of his means, replace the lost loaf of bread by using the second loaf for the more important function and transferring the loss to the less sensitive spot, the feeding of the dog.

#### Discovery Of The "Dependent Want"

The case can be stated as follows. All wants which are more important than the often mentioned "last" remain unaffected by the loss of the one specimen, for satisfaction of them remains assured by requisitioning a replacement. Nor are those wants affected which are still less important than the "last," since they were not to be satisfied whether or not the one specimen was lost. Of all wants the only one affected is the last one of those previously covered. That want is satisfied when the good is present, it remains unsatisfied when the good is absent. It is the *dependent want* we have been looking for.

#### What Marginal Utility Is

That brings us to the goal of our present search. *The magnitude of the value of a good is determined by the importance of that concrete want or partial want which has the lowest degree of urgency among the wants that can be covered by the available supply of goods of the same kind.*

*Value is determined then, not by the greatest degree of utility which a good affords, nor by the average utility which goods of that kind afford, but by the smallest degree of utility for which, in whatever concrete economic situation obtains, it is rationally advisable to expend the good or its equivalent. [Italics added.]* That is rather a long-winded description of the situation, and to be entirely correct it really ought to be even somewhat more long-winded.

But we must be spared such prolixity in the future when we wish to refer to this minimal usefulness which stands on the borderline of the economically admissible.

So let us follow the example of Wieser and speak of it tersely as the economic *marginal utility* of the good. And now we can formulate the law of the magnitude of the value of goods as follows. *The value of a good is determined by the magnitude of its marginal utility.*

#### The Prime Importance Of The Idea Of Marginal Utility

This proposition is the crux of our theory of value. But it is more than that. It constitutes, in my opinion, the key that opens the door to an understanding of the broadest fundamentals underlying the behavior of economizing men with respect to goods. It applies equally well to both the simplest cases and the exceedingly complicated situations which abound throughout the multiform manifestations of our modern economic life. Everywhere we see men making valuations of goods on the basis of their marginal utility and ruling their *actions* in accordance with the results of those estimations. And in view of that the doctrine of marginal utility may be regarded as the crux, not only of the theory of value, but of every explanation of man's economic behavior, and hence indeed of the entire field of economic theory.

Even when people act altruistically rather than selfishly they have good reason to take marginal utility into account. In this case it is the marginal utility which the goods to be given to other persons have for the recipients. Donations and alms are given when their significance in promoting well-being, as measured by their marginal utility, is far greater for the recipient than for the donor. The reverse is virtually never true. [This paragraph was originally part of a footnote.]

I do not consider that pronouncement [of the supreme significance of marginal utility in both the science of economics and in the determination of human action] an exaggeration, and I am confident that anyone who understands the art of observing life accurately will be convinced of its correctness. To observe aright and to interpret observations aright is an art which is at times far from easy. To practice that art we will do well to avail ourselves of the theory of value insofar as such practice falls within the domain of that theory. I propose to follow my own advice in the pages to come, and I shall begin with an example of the greatest conceivable simplicity.

#### An Example Of Action Determined By Valuations Based On Marginal Utility

A pioneer farmer, whose solitary log cabin stands in the primeval forest far from the paths of commerce, has just harvested five sacks of grain. These he must "make do" until the next harvest. Being a methodical soul he lays careful plans for the use to which he will put them. One sack is absolutely essential as the food supply which is to keep him alive until the next harvest. A second sack will enable him to supplement his meals to the point where they will keep him at full strength and in complete health. He has no desire to eat more grain in the form of fancy breads and sweet puddings, but he would like very much to add some nutriment in the form of meat to his farinaceous

diet. Therefore he determines to use a third sack for the raising of poultry. He devotes a fourth sack to the distilling of brandy. Now that his modest personal wants are fully provided for by the arrangements just described, he can think of no better use for his last sack than to feed it to a number of parrots whose antics give him pleasure.

It stands to reason that these uses do not rank equally as to their importance to him. In order to arrive at a brief numerical method of expressing our facts, let us set up a scale of 10 degrees of importance. In that event our pioneer farmer will naturally assign the maximum grade of 10 to the preservation of his life; he may call the preservation of his health worth a rating of 8; then descending the scale he might rate the improvement of his cuisine at 6, the enjoyment of his brandy at 4, and finally the keeping of parrots at the lowest conceivable mark of 1. And now let us put ourselves in the pioneer's position and ask ourselves what is the significance for his well-being of *one* sack of grain?

We are already aware that the simplest way to establish that is to determine what loss in utility would be represented by the loss of one sack of grain. Let us apply that yardstick. It is quite obvious that our man would be most foolish to make good the loss of the sack out of the food that goes into his mouth and thus sacrifice his health or even his life, and yet continue to distill brandy and feed chickens and parrots as before.

Upon sound reflection only one solution is conceivable. Our pioneer will use the four remaining sacks to cover the most urgent groups of needs and will renounce the enjoyment of only the least important, the final, the "marginal utility." In this case that is the keeping of parrots. Having or not having the fifth sack makes no greater difference to him than the ability, in one case, to indulge himself in the pleasure of keeping of parrots or in the other case, the inability to do so. And this unimportant utility will afford a rational basis for the estimation of the value of a single sack of his supply of grain. And that means *every* single sack. For if the five sacks are all exactly alike, it will be all one to the pioneer whether he loses sack A or sack B—just so long as its background harbors four other sacks with which to meet his more important wants.

Now let us modify the illustration. Let us assume our pioneer under the very same circumstances possesses only three sacks of grain. How high a value does he now place upon a sack of grain? The test is again quite easy. If our pioneer has three sacks he can cover the three most important groups of wants with them. And that is what he will do. If he has but two sacks he will restrict himself to satisfying the two most important groups, and have to forgo the third group of wants, the eating of meat. The possession of the third sack means for him nothing more and nothing less than the satisfying of the third most important group of wants, that is to say the final group that is provided for when his whole supply totals three sacks. When we say "third sack" we do not mean any certain individual sack, but rather any one of the three sacks, pro-

viding only there are still two more to "back it up." To value it on any other basis than that of its final or marginal utility would be contrary to the factual situation and therefore a fallacy.

Let us make a final supposition, namely, that our pioneer under the same conditions possesses only a single sack of grain. It is now crystal clear that every other disposition is out of the question, and this one sack must be devoted to and used for a bare subsistence, for which it is just adequate. It is just as clear that if the pioneer loses that single sack he will no longer be able to maintain life. The possession of it therefore signifies life, its loss means death. The single sack of grain has the greatest conceivable significance for the well-being of the pioneer. And once more the valuation occurs in absolute adherence to the principle of marginal utility. For the supreme utility, the preservation of life, is now the only utility and as such is at the same time the last, the final, the *marginal* utility.

And all these valuations in accordance with the marginal utility are not merely "academic." Quite the contrary. Nobody will doubt that our pioneer's practical behavior will be governed thereby in whatever situation arises. Suppose someone made an offer to buy his grain. There is no doubt that any one of us in his position would be inclined to sell *one of the five sacks* relatively cheaply, and quite in keeping with its small marginal utility. We should be willing to sell *one of three sacks* only at a considerably higher price, while the irreplaceable *one and only sack* with its enormous marginal utility would not be for sale at any price, however high.

#### Marginal Utility In A Highly Organized Society

Let us shift the theater of action from the lonely primal forest to the hurly-burly of a highly developed economy. Here the situation is under the veritable domination of the empirically familiar proposition that the value of goods is in inverse proportion to their quantity. The more goods of a given category are on hand, the smaller, other things being equal, will be the value of the individual specimen and vice versa. [However, this is a much inferior formulation of the economic law explaining the influence of quantity on price.—Editor of F. P.]

It is a matter of common knowledge that economic theory has utilized this elementary empirical proposition in the field of the doctrine of price, to set up the law of "supply and demand." But the proposition is also valid quite independently of exchange and price. How much more highly, for instance, does a collector prize the only specimen of a given category, than when that same category is represented by a dozen identical specimens! It can easily be shown that such facts as this, so well attested by experience, follow as a natural consequence from the operation of laws in full accord with the theory of marginal utility. For the more numerous the specimens of a given category of goods are, the more completely can the wants dependent on them be satisfied, the less important are the last wants which still achieve satisfaction and the satisfaction of which



would be at stake if a single specimen were lost. In other words, the more numerous the specimens of a given category of goods, the lower the marginal utility which determines value. And to complete the picture, if there are so many specimens available that after complete satisfaction of all dependent wants there are still further specimens of that good available for which no useful employment can be found at all, then the marginal utility equals zero, and the goods are without value. [The whole quantity becomes free goods as was explained last month.—Editor of F. P.]

**Why Bread Is Ordinarily  
Cheap, And Diamonds Dear**

And now we have the perfectly natural explanation of the phenomenon that at first seemed so startling — that things with little usefulness, such as pearls and diamonds, should possess such high value, while much more useful things like bread and iron should have a far lower value, and water and air no value at all. It is simply a case of pearls and diamonds being available in such small quantities that the need for them is satisfied to only a very small extent. As a result, the satisfying of the want “descends” only to a rank which denotes a final or marginal utility that is still relatively high. On the other hand—and fortunately—bread and iron, water and air are normally available in such great quantity especially for the rich who can buy pearls and diamonds, that satisfaction of all the more important needs dependent upon them is assured. And there are either very trifling needs or none at all that still depend upon the availability of a single example of the good or on a concrete partial quantity.

Of course, under abnormal conditions such as the siege of a city or a voyage through the desert, water and bread can become scarce. In that case the very limited supplies no longer suffice to cover the most important concrete needs for food and drink. That causes the marginal utility to soar and the value of these otherwise so lightly regarded goods to rise rapidly, quite in accordance with our principle. The conclusion thus logically arrived at finds empirical corroboration in the proverbially exorbitant prices which the most modest foods and beverages customarily command in situations of that sort. And so we can now once more consider those facts which at first glance seemed to deride our principle that the magnitude of value is determined by the magnitude of the utility dependent on it. And lo! instead of conflicting with the theory they furnish a brilliant corroboration of it!

**The Question Of The Accuracy Of The  
Selective Decisions Determining Marginal Utility**

The cases we have considered so far were relatively easy to interpret. But practical life often offers economic complications which are more difficult for the research theorist to penetrate, even though the layman deals with them with consummate ease in actual practice. The solution of the problems they present depends entirely on the accuracy of the selective decision that is arrived at concerning the rank which the marginal utility will under given conditions attain. To that end the following general precept may be

applied, with confidence that it will furnish a universal rule for the solution of all the more difficult problems of value. The economic position of the person called upon to render the decision on the question of valuation must be taken into account from two points of view. In the first instance, the good that is to be valued must be imagined as included in the supply of goods possessed by the economic subject and an estimate must be made as to which concrete wants will represent the lowest grade that will be satisfied. In the second instance, the good must be imagined as excluded or lost, and a new estimate made as to how low a grade of want will now still find satisfaction. The two operations will reveal a certain layer of wants which is deprived of satisfaction. This is of course the lowest layer of the total wants covered by the good. It is this lowest layer that indicates the marginal utility which determines valuation.

There are two principal types of occasion which cause a person to make a valuation. On occasions of the one type he is parting with a good, that is to say, he is giving it away, exchanging it, or using it up. On occasions of the other type he is acquiring a good. The line of thought which he follows in one case is, on the surface, different from the one he follows in the other case. A good which he already has, is valued according to the *deprivation* he suffers; that means it is determined by the last or lowest on the scale of his otherwise guaranteed satisfactions. Conversely, a good that he does not yet possess is valued according to the *addition* in the way of utility which its acquisition entails; that means it is determined by the most important of the satisfactions which the person in his previous situation, when not in possession of the good, would have been unable to procure. Of course, both methods of valuation lead to the same result, for the last or least of the satisfactions that is assured *with* the good is always identical with the first which is no longer covered when one is *without* the good. [This paragraph was originally part of a footnote.]

#### The Important Effect Of A Large Quantity Being Involved

One immediate application of this formula is readily apparent and yet not without theoretical importance. It leads to a recognition of the fact that in some cases the valuation of a good sometimes involves the significance of only one concrete want, in others it involves the significance of many concrete wants which must be considered as an integral sum. In the very nature of things the depth of the layer of dependent wants may vary greatly according to the nature of the thing to be valued. When the latter is a single specimen of a perishable category of goods, such as food, the marginal utility will ordinarily embrace only a single concrete want, or even only a partial want. If on the other hand we are valuing a durable good capable of rendering repeated useful services, or a rather large quantity of goods considered as an integral whole, then the dependent layer of wants will naturally be so deep as to embrace a large number of wants. Under some conditions that number may be very, very large indeed. Hundreds of wants will, for instance, be dependent on the possession or nonpos-

session of a piano or of a ten-cask hoard of wine. In the first instance they will be musical enjoyments, in the second gustatory delights, but in both cases their significance must be summed up integrally to permit a valuation of the respective goods.

In cases of that kind it is possible under certain circumstances for a further phenomenon to be present which may at first blush appear incongruous, but which upon closer examination is susceptible of a perfectly natural explanation. For it may be that the valuation of a rather large quantity will differ widely from that of a single unit of the same good, the large quantity being estimated at a far higher valuation. "Five sacks of grain," for instance, will be rated as worth, not five times as much as *one* sack, but 10 times or 100 times as much. As a matter of fact this is regularly the case when the large quantity which is being valued as an integral sum constitutes such a considerable fraction of the total available quantity of the good in question that its removal will make deep inroads on the satisfaction of the wants of the individual making the value judgment, and leave some concrete wants still unsatisfied which are of a grade of importance materially higher than that of the final or marginal want. In that event, of course, the "lowest layer" which is dependent on the integrally valued quantity of goods embraces concrete wants that occupy several different steps on the graduated scale—that is to say, are of differing degrees of importance. It then becomes a matter of simple arithmetical calculation that the sum of a number of unequal factors is greater than the product derived by multiplying the final, the smallest factor (which is the one that determines the value of the single unit of the good) by the number of factors. It is inevitable that the sum of  $5 + 4 + 3 + 2 + 1$  will be greater than the product  $5 \times 1$ .

#### Marginal Utilities Must Be Added To Get Correct Results

The previous illustration of our pioneer permits us to envision the phenomenon quite clearly. As long as he had five sacks of grain, one of them had a value equivalent to the pleasure of keeping parrots as pets. But when it comes to a matter of three sacks, we find an aggregate of satisfactions dependent on them which is by no means merely the equivalent of three times as much pleasure as keeping parrots. What depends on the three sacks is the pleasure of keeping parrots plus the imbibing of brandy plus the eating of meat. And when all five sacks are considered as an integral unit, not only the last mentioned three wants of ascending importance are dependent on them but in addition the maintenance of health and the preservation of life itself. Surely that is a sum which is not merely five times, but infinitely greater than the pleasure of breeding parrots. Let us imagine that our pioneer is required to place a value on "three sacks" or on all "five sacks" as an integral quantity. Such a situation might arise if a second pioneer should wish to settle in the vicinity and offer to purchase one or the other quantity. It would occasion no surprise if our pioneer were quite ready to sell *one* of his

five sacks at a moderate price, say \$25. But we should not expect him to consider selling the larger quantity of "three sacks" unless he received far more than three times the price of one sack. And finally, he would assuredly not be willing to sell all five sacks together at any price, be it ever so high.

The exact counterpart, that is to say, a disproportionately *lower* valuation of a larger aggregate, can be observed when, instead of being a case of disposing of a quantity of goods, it becomes one of an acquisition of them. If, for example, our pioneer had no grain at all, the purchase of a first and only sack would mean the preservation of life, the purchase of each succeeding sack would mean correspondingly less, and consequently the purchase of five sacks would mean considerably less than five times the value of the first one. It is simply a matter of  $5 + 4 + 3 + 2 + 1$  being less than  $5 \times 5$ . The attentive observer will be able to perceive numerous cases of this sort in practical life and will find that our theory furnishes a key to the ready solution of them. [This paragraph was originally a footnote.]

**Total Value Is Never Equal To Marginal Utility  
Times The Number Of Units, But Far More**

*The subjective value of a rather large supply of goods is therefore not the equivalent of the marginal utility of a single unit of the good multiplied by the number of units comprising the supply. It is determined by the total value derived by adding together the marginal utilities of those units.* [Italics added.] And indeed, so long as the quantity to be valued does not completely exhaust the total available or existing supply, such value is determined in accordance with the principle of marginal utility by the smallest combined utility that is still economically feasible or admissible. The value of "three sacks of grain" in our illustration is not three times the marginal utility of one sack; nor on the other hand is it equivalent to the total utility which any "three sacks" would afford, and which could therefore be that derived from the three most important groups of needs, namely, preservation of life, maintenance of health, and ingestion of meat. Instead, it is determined by the marginal utility that can be derived from the "last three sacks," when expended for the last three purposes that are still economically justifiable. In our example this means the aggregate derived by totalling the keeping of parrots, the enjoyment of brandy and the eating of meat. [In Böhm-Bawerk's previously designated valuations this is  $1 + 4 + 6$  or 11.] Only when the supply to be integrally valued coincides with the total existing or available supply does the total utility of the supply coincide with its marginal utility. This is comparable to the valuation of goods which are available only in the amount of one single specimen of that kind of good. But this is of course no exception to the law of marginal utility. It simply means that because of the maximal limitation of numbers, there is no latitude for the characteristic development of the law to manifest itself. We can say with equal justice that it does not constitute a violation of the law of primogeniture

when in any given instance an *only* son inherits the entire estate of his father.

It should occasion no astonishment to learn that writers who were strangers to the theory of marginal utility or even hostile to it should be bewildered by these complications, and derive from them material for objections arising out of misunderstanding. [This paragraph was originally part of a footnote.]

#### The Quantity Involved Has Important Consequences In Many Cases

In practical, everyday economic life there are innumerable estimations of subjective value. Probably the overwhelmingly greater portion of them will be concerned with single units of a good or a small, even a minute partial quantity thereof. For that reason valuation in accordance with the principle of the marginal utility of the single unit is by far the commonest. And yet there are cases—they constitute a small minority—in which we are impelled or even required to exercise our economic deliberation in connection with very large quantities of goods or even with the total supply of goods of a given kind. This minority of cases includes some that are particularly important and especially interesting. The duty therefore devolves upon me to develop the selective reasoning that deals with the subject of marginal utility to such a point as to offer a key to the understanding of these cases, too.

It may be of some interest to have it pointed out that the familiar power of strikes to exert pressure is founded in large part on the progressive increase of "total utility" in contrast to the "final utility" of the individual worker. The understanding of the theoretical aspect of such cases, and the correct incorporation of them into the general laws governing value becomes more important, the more strongly the tendency becomes manifest in modern economic life to unite persons and goods more and more into consolidated massive bodies by means of organized associations and unions of one kind or another. [Originally this paragraph was a footnote.]

### III On What Does Magnitude Of The Marginal Utility Itself Depend?

I feel it is legitimate to ignore once and for all several other complications of selective rationalization, because they have no bearing on the specific purpose of this book. Others I am ignoring for the time being because they have all too much bearing on our purposes and therefore require such detailed treatment that separate chapters must be devoted to them. At this point I am returning to the simple fundamental law of the value of goods because it needs a little amplification in a certain direction.

For we have been so far citing the magnitude of the marginal utility as the explanation of the magnitude of the value of a good. But we can go a step further in our research into the causes of the value of goods by asking this question: "On what, in turn, does the magnitude of the

marginal utility itself depend?" The answer there is: the *relation between wants and the wherewithal to satisfy them*.

The manner in which these two factors influence the marginal utility has been so frequently and so thoroughly commented on in the foregoing explanations that I can dispense with any further elucidation and content myself with a brief formulation of the pertinent rule. It reads as follows. The more extensive and the more intensive the want is—in other words, the more wants there are, and the more urgently they demand satisfaction — and, *per contra*, the smaller the quantity of good that is available for that purpose, the higher will be the point in the graduated scale of wants where satisfaction will end, or in other words the greater will be the marginal utility. Conversely, the fewer wants there are to be satisfied, and the less urgently their satisfaction is demanded, the lower on that scale will be the point down to which wants are satisfied, and hence the smaller is the marginal utility and the value which must result.

Approximately the same thing may be said, though somewhat less accurately, in a different form. One may say that *usefulness and scarcity* are the ultimate determinants of value. For insofar as the degree of usefulness of a good will indicate whether that good is by nature capable of contributions to well-being which are of major importance or only of minor significance, it simultaneously furnishes a basis for judging the maximum rank which the marginal utility can attain under the most favorable conditions. But scarcity determines the highest point which marginal utility can really attain in a particular concrete case.

#### Subjective Value Is Different For Different Persons

The proposition that the rank of the marginal utility is determined by the relation between want and coverage furnishes material for numerous applications. I shall rest satisfied with selecting two which we shall have occasion to make use of later on when we come to the theory of objective exchange value.

The first is, that the relations of want and coverage vary so in individual cases that the same good may have quite a different subjective value for different persons. Indeed, if that were not so, the effecting of exchanges would not be conceivable at all.

The second is that under conditions that are otherwise identical, equal quantities of goods have quite unequal value for the rich and for the poor, that value being greater for the poor and smaller for the rich. For since the rich are more abundantly endowed with goods of all categories, their satisfactions in general extend downward to include even the more insignificant needs, and the addition or the loss of satisfaction which attaches to a single specimen of a good is therefore relatively unimportant. The poor, however, are able to cover only their most urgent wants anyway, and for them therefore there is an important use depending on *every* specimen of a good. And experience does in actual fact show

that the poor man hails the gaining and bewails the losing of a sum of goods which the rich can gain or lose with complete indifference. Compare the emotional state of a poor clerk who on the first day of the month loses his whole monthly salary of \$250 with that of a millionaire who drops the same amount at poker! For the former the loss means painful deprivation throughout an entire month, for the latter it can mean nothing more than the renunciation of some idle little luxury.

## Selfishness? Relative To Goods Or To Men!

Now that the reader, from perusal of the foregoing, has a preliminary understanding of the relationship of men to goods, what may his conclusion be regarding selfishness?

1. *Before* a man's relations to other men can be a problem, there is a *prior* problem, the relationship of that man to goods. In regard to that relationship a man is *always* selfish. Man was not created for goods; goods were created for him. The essential nature of the relation of man to goods is purely one of his self-welfare. What other principle *could* a man follow and still be rational?

2. Man's relationship to goods is complex and ever changing, because the wants of men are invariably variable and circumstances are also changing constantly. No two cases are ever identical. Consider the variability of wants, diminishing returns, marginal utility.

\* \* \*

Böhm-Bawerk dealt with a simple case, an isolated farmer possessing five sacks of grain. What problems arise when we think of two farmers, each with five sacks of grain? Let us call the farmer whom Böhm-Bawerk has been considering, Farmer *A*; and the second farmer, Farmer *B*.

Farmer *A* used (1) one sack for himself to avoid starvation; (2) another sack to have full health and strength; (3) a third sack for raising poultry; (4) a fourth sack to distill whiskey; and (5) a fifth sack to feed parrots which he desired for his entertainment.

A natural question is: Will Farmer *B* use his five sacks identically? Secondly, should he?

\* \* \*

3. It is an impossibility that Farmer *B* will wish to devote his five sacks to the same purposes as Farmer *A*. He may be

a bigger or smaller eater, and may wish a different quantity of corn for himself. He may prefer beef to chicken; he may not care for whiskey; and may dislike parrots. He allocates his five sacks to different purposes than Farmer A. We can then answer the first question in this manner: the relationship of one man to goods will always be different from any other man to goods. *Equality is impossible.*

4. Further, it may be added, that *equality is undesirable.* The only way to obtain equality is that Farmer A coerce his choices on Farmer B; or vice versa; or that they compromise so that A has his way on some subjects and B on other subjects. But why not let each make his own decisions? Only then are these two men "meek" toward each other. Only then will they be able to get the maximum enjoyment for themselves—when they can follow *their own* choices, and thereby have the strongest feeling of well-being. Only then can the statement in the Sermon on the Mount be true: "Blessed are the meek *for they shall inherit the earth,*" i.e., they will have the greatest sense of well-being, if everybody is left free (in this case, *free* to use his five sacks of grain as *he* individually wishes.) Obviously, *meekness*, when correctly defined, results in the highest level of well-being—an "inheriting of the earth" by the people therein.

5. Further, note the peculiar subjectivity of all valuing of goods. How could A properly undertake to decide for B? Is not all valuing for *others* a demeaning of the others? To undertake to determine values for others is to indicate that you consider them inferior. *Valuing* for others is intolerable arrogance because the man who undertakes to decide for others in effect considers himself a god in knowledge.

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Objectives In Current Issues

In current issues of FIRST PRINCIPLES the attempt is made to explain, and make convincing, various propositions which are somewhat different from those usually accepted; they include the following:

1. That ideal understanding of the validity of the Ten Commandments of the Hebrew-Christian religion includes more than its acceptance on faith, as revelation from God. If a reader's principles of ethics are rules which he has accepted *on faith* only, without supplementing them with reason and realism, then he will find that the current issues of FIRST PRINCIPLES offer him a new and valuable viewpoint.

2. That in order fully to understand the validity of the Commandments in the Hebrew-Christian religion which govern the *relation of men-to-men*, it is necessary to have a prior understanding of the *relation of men to things*. If a man undertakes to understand the rationale of a system of ethics, he must first have a realistic cosmology. A system of ethics which assumes that unlimited abundance, and goods sufficient to *satisfy* everybody, are a possibility is a system that is too primitive, and romantic, to warrant serious consideration. The need for ethics

has its origin in the sober fact that there is a natural, initially-created, *universal welfare shortage*. Not only is that the origin of the need for ethics, but it also provides the clew for the ultimate understanding of the merits of propositions pertaining to ethics. Cosmology must be antecedent to rational ethics. If a man has a docile temperament and accepts the ethics of the Hebrew-Christian religion on faith only, he will get along well. If he is less-trusting and analyzes the Ten Commandments of Hebrew-Christian ethics rationalistically, then his original credulous acceptance of them will be fortified, and he will get along even better. But if he wishes to leave unanalytical trust behind him, and not only accepts the ethics of the Hebrew-Christian Decalogue on faith, and also on the basis of its conclusive internal validity and consistency, but goes further and accepts it also because he understands the antecedent questions pertaining to the relation of men to things, then he will have arrived at a more comprehensive understanding and will obtain an overwhelming conviction regarding the ultimacy of Hebrew-Christian ethics. He will no longer see reality "in a glass darkly" nor will he any longer "think as a child." He will have put away "childish things" and will see the ethical world with the sophistication of a man. Christian ethics only *appear* to be adequately explained when that part of the Ten Commandments pertaining to the relations of men to men is analyzed *in abstracto* as the revealed will of God, but without reference to things. Actually such an approach leaves those Commandments "rootless" like a tree ripped out of the ground without any dirt around its roots. The *roots* of the ethical commandments, being logically imbedded in the relation of men to things, will be exposed, figuratively speaking, to the withering and killing effects of sun and wind — to a lack of realism. What soil is to a tree, the relation of men to things is to the relation of men to men.

3. That seeking self-preservation and self-welfare are equally meritorious principles, and fundamental to individual and social

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welfare. Acceptance of the idea that the pursuit of self-welfare is ethical is one of the principles underlying that sound philosophical perspective of life, known as Individualism. Contrarily, Altruism, or the principle that a man is responsible for all of his neighbors, and may not properly pursue his own welfare first, is intellectually as sorry an ethical doctrine as has yet been fabricated by the mind of man.

4. That, although the pursuit of personal self-welfare is subject to abuse, and constantly *is* being abused, nevertheless there is a "built-in"—automatic—protection against that abuse, namely, the disciplinary effect of the pursuit of their own self-welfare *by all others*. If people are, by the principles of ethics they accept, left free to exercise their own freedom to protect their self-welfare from encroachments by others, they will be effective in doing so, and the *general consequences* will be favorable. Economics assumes people will operate to protect their self-welfare (but, of course, it does not tolerate coercion, fraud and theft any more than do generally accepted principles of morality). But there is small possibility of understanding this "built-in" protection of society, derived from letting *all* men exercise the pursuit of their self-welfare, unless one understands *how* people arrive at their individual "subjective values" and how "prices" (objective exchange value) are determined.

5. That when *all* men are legitimately permitted to exercise the pursuit of their self-welfare, then most of the benefits of the greatest contributions of the ablest of men—those who are superior—are inescapably *distributed* to their fellows. The great men *cannot* "hog" much of the results of their own efforts. In a genuinely *free* society, its great men retain only a modest fraction of their *extraordinary* contribution. Free price determination and competition are the most effective distributing forces—egalitarian forces in a sense—in the world. The erroneous popular understanding is to the contrary. The correctness of the foregoing allegation will become obvious from the contents of later issues.

6. That those moralists who say that a coercive power of some sort may properly interfere with the operation of the "free market" thereby unwittingly help to create circumstances which (1) will impoverish society generally, (2) will create benefits which are

undeserved and unjust, and (3) will contribute eventually to a class-ridden society. Their means-to-their-end turn out always, by experience, to be contrary to purpose, and in a sense suicidal. Their "means" consists in coercion via an enforcing power, presumably a beneficent government. This is a recourse *contrary* to Hebrew-Christian ethics, and eventually is catastrophic.

7. That the "common man" although often misled by moralists and altruists is in his practical conduct genuinely wiser than the theories of the theorists. It is primarily in proportion as the intellectuals seduce him by advocating to him collective coercion, via government action, that he takes an evil course, in violation of the Commandments of God. All men are prone to have facile recourse to coercion, fraud and theft; unfortunately, we all descend to those practices almost as our first-proposed course in every situation. But the subject that is in dispute is not the propriety of government *to restrain evil*. It is when government undertakes *to do positive good* that it becomes a Frankenstein monster. It is that kind of a government that the hyper-moralists continue to urge upon men.

8. That finally there is complete agreement on conclusions derived from four sources for rules of conduct, namely, from (1) ancient principles of morality; (2) far-sighted judgment; (3) principles of economics, and (4) experience. These four "teach" identical doctrines.

## How Complex Marginal Utility Becomes In A Highly Organized Exchange Economy, And In A Freely Producing Society

The analysis in the May issue of FIRST PRINCIPLES describing what marginal utility is, in the case of five sacks of grain in the possession of an isolated farmer, probably was more complex than readers had expected. But the previous quotations only begin to probe into the subject. By perusing what follows, readers will become aware that their own "reaction" to things is both remarkably flexible (complex) and self-regarding. The examples given make clear that a man, when he determines the *value* which he places on a specific thing, is always engaged in "loving himself," that is, in pursuing his self-welfare.

The Hebrew-Christian Scriptures require of a man that he love his neighbor *as himself*. How a man does in fact *love himself* is evidenced by how a man reacts to the world of things around him. And when man is observed when so reacting, then it is obvious that he endeavors to maximize his self-welfare, or the self-welfare of others with whom he is intimately associated and whose "satisfaction of needs" he is in a position to appraise reasonably well.

But he *never* places *things* ahead of *himself*. He treats things, or more accurately, goods, as mere means to his ends. And when he can do that with freedom, then he attains the highest level of satisfaction that is possible for him. Further, if that man really loves his neighbor as he loves himself, then that love is primarily manifested by his tolerating that that neighbor has as much freedom in endeavoring to maximize his self-welfare as the first man has in endeavoring to maximize his. Any other definition of "loving the neighbor" degenerates into charity which is a system which, except in emergency, is destructive of the morale of the recipient, and if universally applied is suicidal to society. No system for society can possibly be more harmful to its members than *universal alms*. The consequences to the recipients are positively vicious.

The most salutary factor in society is the universal inclination among men to maximize their *self-welfare* and to *minimize their self-injuries*. The resourcefulness of men in their endeavor to accomplish those ends runs into infinity. In the quotation which follows from Böhm-Bawerk's Chapter IV in his Book III on "Value" in his Second Volume of his famous work, *CAPITAL AND INTEREST*, two important factors affecting *value* and *marginal utility* are briefly considered, namely, (1) how *by exchange* men (a) reduce the penalty they suffer from losses, or (b) enhance their marginal utility; and (2) how the capacity for augmenting the supply of a product will affect marginal utility and value.

The quotation makes obvious how adroit men are in "loving themselves." And it may properly be added that that adroitness in seeking their self-welfare is one of the finest things about the members of the human race.

## HOW THE MAGNITUDE OF VALUE IS AFFECTED BY EXCHANGEABILITY OF GOODS, AND BY GOODS BEING PURCHASABLE IN ANY DESIRED QUANTITY

### I

#### Marginal Utility Is Not Necessarily Measured in Terms Of The Utility of Another Unit of the Same Good, But Often in Terms of the Utility of Altogether Different Goods

This brings us to a complication that is of extremely great interest and has very far-reaching effects. As we know from our previous analysis, the marginal utility which determines the value of a good is not—barring accident—identical with the utility that is actually derived from the good itself. [See pages 150-157 in the May issue.] It is as a rule a disparate utility, the utility of the last specimen of the good, or of the least partial quantity of uniform magnitude, which is available as an example of that good.

In simple relationships this utility, though that of another unit of the good, is at least that of a good of the same category. In the illustration previously used, the value of each single sack of grain—let us say the first—was determined by that of another, namely, the last sack. But still it was at least a sack of grain.

#### How Far Afield Men Go To Reduce The Penalties From Losses, And To Maximize Values

But the existence of a well-developed system of exchange of goods can cause considerable complication in this respect. Since it makes it possible at any moment to exchange goods of one category for goods of another kind, it also makes it possible to transfer a loss from the category in which it occurs to a different category. Instead of making good the loss of a specimen by withdrawing one unit of the same category from a less important use and leaving the latter uncovered, it is possible to divert goods of utterly different categories from the purpose previously intended, and exchange them for the required substitute unit. What the loss of a good of one kind really causes us to be deprived of is the use which the substitute goods of a different kind would otherwise have rendered. However the latter, too, would be drawn not from the more important, but rather from the least significant uses in their own sphere of utility. Therefore what is lost is the marginal utility of the substitute disparate goods. Therefore the measure of the marginal utility and hence of the value of a good of one kind is the marginal utility of that quantity of goods of an unrelated kind which is required as a substitute.

#### The Marginal Utility Of A Stolen Winter Coat

Let us illustrate. My only winter overcoat is stolen. There can be no question of direct substitution of another specimen of the same category, because it was, as I said, my only one. Nor do I desire to endure the loss caused by the theft of the coat, in the quarter where it was inflicted on me. For the need for warm winter clothing, which is being deprived of satisfaction, is a highly im-

portant want, and failure to provide for it may entail extremely harmful consequences to my health or may even cost me my life. I shall therefore attempt to transfer the deprivation to other categories of goods.

Translated into concrete acts, that means that I purchase a new winter overcoat with goods which would otherwise have been devoted to other uses. Naturally I draw the substitute goods from the uses which mean least to me, in other words, from their "marginal utility." (1) If I am well-to-do, I shall probably simply draw a check for the \$150 the new winter coat may cost me, and be able to draw on my reduced bank account for one or two luxury items fewer. (2) If I am not well-to-do but not poor either, the blow to my pocketbook will have to be made good through all sorts of economies that may affect my housekeeping budget for the next few months. (3) If my means are so limited that I neither have the purchase price in cash nor can raise it in instalments out of my monthly income, I shall have to pawn or sell some furniture or other object that I can more easily get along without. (4) And if, finally, I am so poor that I can meet only the supremely important concrete wants in all categories—well then I just cannot transfer the loss to any other category of wants, and I shall willy nilly have to "grin and bear it."

If we can succeed in vividly imagining ourselves in the very position of the owner of the winter coat, and then ask ourselves what contribution to well-being depends on the theft of the coat, we will find the following answers. (1) In the first case it is an expenditure for a luxury or two; (2) in the second place it is the practice of a few economies in housekeeping; (3) in the third case it means the use of the articles that have to be pawned or sold; (4) in the fourth case it is the effective safeguard of health. Only in the last case is the value of the winter overcoat determined by the direct marginal utility of its own category. That applies because here, where the category is represented by only one specimen, the marginal utility of the category coincides with that of the specimen itself. In all the other three cases the value of the coat is determined by the marginal utility of unrelated categories of goods and of wants.

#### **A Highly Developed System Of Exchange Affects Marginal Utility**

The modification in selective reasoning which I have described finds extraordinarily wide application in our economy, characterized as it is by a highly developed system of exchange. I should say that the majority of subjective estimations of value that are made at all, are of this kind. For reasons easily to be inferred from what has just been said, we almost never estimate the value of goods which are indispensable to us according to their direct utility, but in nearly all cases according to the "substitution utility" of unrelated categories of goods.

Nevertheless I should like to point out explicitly and emphatically that even though we apply the latter method of estimation very frequently, we do so only under certain conditions. Those conditions do not by any means invari-

ably prevail even amidst extremely highly organized conditions of exchange. We follow the method only when the marginal utility of the substituted unrelated goods is inferior to the direct marginal utility which obtains in the same category. It might be more accurate to say that the substitution method is employed when the prices of goods, and at the same time the conditions under which needs are supplied, are such that making good a loss occurring in any category by replacement from within that same category results in failure to satisfy wants that are relatively more important than those which must remain unsatisfied when a different category is drawn upon for the price of the substituted unit. No matter how involved the complications, it is always the *smallest* degree of utility directly or indirectly attaching to a good which indicates its genuine marginal utility and its value.

\* \* \*

I should like to remark parenthetically that this was one of the reasons why I added to my description of "marginal utility" a further comment that the "longwinded" definition, to be entirely correct ought to be even more longwinded. [See page 149 in the May issue.] For the concluding words in italics "goods of the same kind" should be amplified to read "and also goods of the same kinds that are readily convertible into goods of the same kind." Similarly the last words of the next sentence, "or its equivalent" should be expanded to read "and all substitutes capable of prompt rendition of the same useful services." But there is still something more to be considered in that connection.

## II

### The Influence Of "Augmentable Supply" On Marginal Utility And Value

When we considered the elementary example we regarded the supply of goods which provides, as it were, "coverage" for the need of goods of a certain kind, as a given, definitely determined magnitude. The conditions of our illustrative hypothetical cases assumed fixed and unalterable quantities. This was true of the loaves of bread in the first example [on page 148] and of the sacks of grain in the second [on page 150]. That presupposition must now be abandoned.

We are now going to treat the supplies of a certain kind as what in practical economic life they are for the most part. There they are a magnitude which is, to a certain extent, elastic, a magnitude that within certain limits can be extended, supplemented or pieced out. We therefore now pose the problem of marginal utility with an inescapable added difficulty. That difficulty is the fact that with the magnitude of the supply being variable its terminal point also becomes variable; that also shifts the position of the "last unit" which concludes the supply of goods; and finally that makes a variable of the marginal utility which determines value. The thing which was a veritable Archimedean fulcrum when our supply of goods was fixed, now itself becomes an elusive  $x$  that has to be determined. But it is an  $x$  that is susceptible of determination.



**There Is Always A Welfare Shortage**

The elements required for its reliable determination are always inherent in the total situation. Even the "augmentable supply" is limited by conditions. It encounters its limitations as the result of a sort of "turn and turn about" which it enters into with the other classes or branches of wants and goods. It is capable of piecing out, but only at the expense of other categories of wants and of goods. From their "coverage" some additions can be pieced on, but only to the point where the substituting, the "turn and turn about" leads to an equalization, to a balance in the relationship of need and coverage among the different classes of need and of good, to a harmonizing of the marginal utility of the quantities of substitutable goods in the various categories of goods.

**Men Distribute Losses Just As Water Is Equalized In Several Vessels**

The situation may be compared to that which prevails when we consider the level of water in a number of vessels of varying size which stand beside one another and which are connected in such a way that valves, which can be opened at will or which open automatically, permit free intercommunication between vessels. The water level in any *one* of these vessels is then not determined exclusively by the magnitude of the mass of water that happens to be in that one vessel at a given moment, nor by what happens in that one vessel. The drawing off of water to the extent of one-third of that vessel's capacity would not result in the dropping of the water level in that vessel by one-third. Instead, the opening of connecting valves to better filled communicating vessels would result in an influx of water until finally a uniform water level could be observed throughout the whole set of vessels. This water level would certainly not be anything arbitrary or fortuitous, but something which the conditions pertaining to the influx and efflux of water throughout the whole set of communicating vessels would determine and would render precisely determinable.

**Exchange And New Production "Disperse" Marginal Utility**

In the same manner exchange opens up valves to partial supplies of goods in other categories. The same thing is also effected by production, as we shall later have occasion to convince ourselves, for production permits renewal or increase of whatever supply of goods is at the moment on hand in every category.

In both cases we have an addition to the number of the facts and the data which exert a determining influence on the magnitude of the marginal utility, but there is no change in their nature. "Need and coverage" are no longer the isolated need of goods of an absolutely definite kind, nor the correspondingly isolated supply of those goods; the terms now apply to the data for needs and coverage throughout all communicating branches.

But in this extended field it is still true that a given magnitude of combined needs is faced by a similarly limited and fixed total magnitude of a combined supply. And the relation of the two magnitudes again supplies the basis for following our familiar rule and determining

for each concrete partial quantity of goods the marginal utility applicable to the total supply of that good.

#### The Welfare-Shortage Remains

But no matter how great the "augmentability" of supply may be, it is clear that we can never remove ourselves entirely from the influence of the element of limited supply—supply that is scarce in relation to wants. Nor can that be cause for astonishment to anyone who keeps in mind that the inadequacy of the means of satisfaction for coverage of the wants that demand satisfaction constitutes the basic relationship which stimulates and forces us into economic behavior at all. It must be remembered that the destruction of that relationship of insufficiency would mean the abolition of all our economic activity.

Readers will now understand how complex the relation of men to goods is. This complexity is not hard for the average man to understand once the ideas have been explained to him. But until they are explained the average person carelessly *assumes* that his relationships to goods are very simple. *The philosophers and moral teachers have assumed the same thing, and, by assuming that, they lost the real clew to the most basic solution that there can be to questions of morality and justice.*

From the foregoing quotation, together with what was quoted in the April and May issues, it can now be easily understood by anyone:

1. That marginal utility *even within one category of goods* is a basic and fascinating phenomenon (see pages 150-152 in the May issue);
2. That marginal utility is even more interesting and informative when it crosses the lines from one type of goods to all other types of goods, through the medium of exchange (see the remarks quoted in the foregoing about the stolen overcoat); and
3. That marginal utility becomes even more complex, interesting, and fascinating when new production of a good affects the supply.

What has been accomplished by this description of what happens in everyday life is that we can now begin to understand how men distribute the burdens of life. Having begun to understand that, we can by further thought and reasoning, eventually understand what justice and brotherly love are and how they may best be attained.

But lacking an understanding of marginal utility, a philosopher or a moralist remains a shallow ethical thinker.

## Pursuit Of Self-Welfare As The Foundation Of Ethics And Morality

The *proper* foundation of all human action—and of all morality—is the pursuit of self-welfare. Not only *is* it that way, it *has to be* that way.

Some ethical teachers, influenced by some of the statements of Hebrew-Christian ethics, will object to such a formulation of the foundation of ethics, but they base their opposition on (1) manifest misinterpretation of statements in the Hebrew-Christian Scriptures, and (2) neglect of analytical, *rational* thinking.

The central position of *self-welfare* in human action, and in the ethical principles which undertake to appraise human action, is evident only when the *two* groups that are external to us, relative to which we seek welfare, are distinguished and considered separately. Those two groups are (1) economic goods, that is, things both useful and scarce, and (2) other human beings. A prime cause of confusion in ethics consists in considering only the latter, and in *ignoring the former*. *Rational* morality depends on beginning with men's relation to things.

*Economic goods* includes inanimate things—houses, automobiles, clothes. But it also includes some living things, both plants and animals. Relative to all things lower in rank than human beings, whether animate or inanimate, the welfare of mankind is always given precedence. The exceptions are by those suffering from mental aberration. Things are *for* men; men are not *for* things.

When there is only one person in the situation, as a Robinson Crusoe, nobody disputes the foregoing. In the example quoted in the last issue about an isolated farmer with five sacks of grain, the third sack was assigned to feeding chickens, the fourth sack to making corn whiskey, and the fifth sack to feeding parrots kept for amusement. All these involved *living* things—chickens, "bacteria" to produce whiskey, and parrots. Few will dispute however, that if three of the five sacks were lost and only two were left to sustain the farmer, he should not let himself starve to death instead of his chickens, his "bacteria," or his parrots.

Confusion arises only when a relationship of men-to-men enters the picture. Up to that point a man, by universal, ra-

tional consent, will and may make decisions *for his own benefit*, that is, as the expression goes, selfishly.

\* \* \*

But what if the isolated farmer is isolated no more, but gets a neighbor? Up to the time of the arrival of the neighbor, our farmer was morally and ethically making decisions only for himself. Must he now, to be ethical and moral, make decisions (1) only for the benefit of his neighbor, forgetting himself? (2) equally for his neighbor and himself, that is, fifty-fifty? or (3) what should the percentage relation be? To those questions, if principles of ethics or morality are to be meaningful, the answers must be *definite* and not generalities.

There are moral teachers who say that the goal of life is to "overcome selfishness by love." Those four words are not understandable unless *selfishness* is defined and *love* is defined. Where does selfishness begin for our *isolated* farmer? He has five sacks of grain and he uses them all. But after a neighbor arrives, how many sacks of grain, if any, must he allocate to his neighbor? What betrays his selfishness? What will evidence his love?

Suppose the neighbor has three sacks of grain of his own. Suppose, further, that the neighbor has chickens, bacteria and parrots, too, and proposes to devote his three sacks to having chickens, whiskey, and parrots, *but he will then lack the two sacks needed to keep himself alive and strong*; in other words, the neighbor is a fool, who by temporarily living imprudently will soon be destitute. Must the first farmer sacrifice *his* chickens, *his* bacteria and *his* parrots because the second farmer has "lived high" on chickens, whiskey and amusement but now lacks enough to keep himself alive? In other words, in a sound social structure, how far is a man who is wise and calculating *about things* to be protected against the problems created by a fool? Or is he to have no protection, but is he instead supposed to live "unselfishly in love?"

\* \* \*

Obviously, *how* people make decisions regarding the *marginal utility* of mere things determines their ethical problems. If the first farmer makes certain decisions about the marginal utility of five sacks, then that will determine his life and well-being, and also his ability to help another. Similarly, if the second farmer

makes other decisions about the marginal utility of what he has, then that will determine his life, his well-being, and his need for help or his ability to help. If there are many people in the community who are imprudent about things, then the marginal utility problems will be of one sort. If there are many *prudent* people, the situation will be different.

If the newcomer, Farmer B, is genuinely improvident, but if the first farmer shares *equally* with him, then the second farmer has no penalty for his improvidence, and the first farmer has no reward for his providence. Sharing the *consequences* of personal decisions on marginal utility results eventually in the complete annulment of incentives for prudence and against imprudence.

The crucial factor in the situation is the wisdom, or unwisdom, of specific decisions on marginal utility. If one man makes unwise decisions on marginal utility, should he be permitted to continue to make those unwise decisions, or should wiser men take such decisions away from him and retain it for themselves, or should it be given to some group of men?

The giver of charity does not correct the cause of unwise decisions on marginal utility; he only ameliorates the consequences of unwise decisions. The real solution must be the promotion of more decisions that are wise. But how?

To that question both reason and Hebrew-Christian ethics give the same answer, namely, do all you can to influence (educate) the less-wise man for good in questions of marginal utility, *but do not coerce* him, let him make his own decisions; be "meek" toward your fellow man, by not *coercing* his judgments; only put forth extraordinary efforts to *educate* him.

*Reason* gives the same answer, *for this reason*: the first farmer *cannot really know* what marginal utility decisions the second farmer should make, because men differ, have different tastes, wish to make different choices. Even if the first farmer was able to do a fair job in regard to one neighbor and if that were permitted, then should he be permitted to do it for many neighbors, in fact, for all? But then the impossibility, and the arrogance and insolence of the attempt becomes apparent. *Each man should be left the liberty of making his own decisions on matters of marginal utility.* No man's mind is knowing-enough to be wise

for all others. To be qualified to that degree, a man would have to be omniscient. Therefore, to be a fellow man's "keeper," in a material sense, would require that we be omniscient. None of us is. In the final analysis, the *foundation* of the logic in favor of freedom rests as much on *the finiteness of our minds*, as it does on imprescriptible rights of personality. Because a man has only a finite mind, he should not attempt to make decisions for (all) others. (Consider also the unwisdom of a father who undertakes to make all the decisions for his adolescent son, or the mother for her daughter.)

The Hebrew-Christian Scriptures specify, on authoritarian grounds, exactly what logical realism specifies. Those Scriptures do not grant any right of coercion except to resist certain specific evils. The Scriptures nowhere authorize any man to *compel* another *to do good*: they only authorize a man to resist evil, and this resistance to evil is further limited to resistance *by good and proper means only*. In positive form, the scriptural requirement is "Blessed are the meek (those who do not coerce others) for they shall inherit the earth" (Matthew 5:5).

\* \* \*

Ethical teachers may be reluctant to relinquish the principle which so many of them love, that is, that each man should be his "brother's keeper." *But they can retain their principle only after they have shown the competence of every man to make proper marginal utility decisions for all his neighbors.* That is something no man is capable of doing.

Marginal utility decisions are too difficult, too complex and too different, for one man to make for another.

## Why The Unions Are So Insistent On Union-Shop Monopoly And On Strike Power

(A SELDOM REALIZED REASON)

(*A case where 1,000 times x is not equal to 1,000x*)

Marginal utility calculations are made by everybody, but the more astute a man is the more skillfully he observes the laws relating to marginal utility. Men who are capable enough to become powerful, or rich, are greater experts in the utilization of the laws of marginal utility than the average man.

The men who constitute the top leadership of unions are

capable. For their purposes they demand "closed shops" (or "union shops" which are almost the same thing as closed shops), and they create an atmosphere that strike power is a holy power. Böhm-Bawerk, in what we quoted from his CAPITAL AND INTEREST in our May issue, wrote the following (page 157):

" . . . . The familiar power of strikes to exert pressure is founded in large part on the *progressive increase of "total utility"* in contrast to the "final [or marginal] utility" of the individual worker. The understanding [of the theories of marginal utility], . . . and the correct incorporation of them into the general laws governing value becomes more important, the more strongly the tendency becomes manifest in modern economic life *to unite persons and goods more and more into consolidated massive bodies by means of organized associations and unions of one kind or another.*" (Our italics.)

This "tendency" to which Böhm-Bawerk refers has become more significant in our economy than it was in his.

The "leverage" that one employe has in a dispute with his employer is as small, or large, as it is freely determined according to the laws of marginal utility. If there are 1,000 employes, the natural conclusion would be that the 1,000, if they work in concert, will have 1,000 times as much influence as one employe; that is what nearly everybody thinks. But Böhm-Bawerk says something entirely different. He says that the 1,000 have *much more than 1,000 times as much effect as the one had*. If that is true, then the "logic," *from union leadership standpoint*, for closed shops, union shops, strikes, and intimidation and violence on a picket line *in order to obtain MASS conformity*, makes far more sense than a conclusion based on mere multiplication by numbers, in this case 1,000 times  $\times$  (with  $\times$  standing for the marginal utility power of one employe).

Only if one understands what Böhm-Bawerk carefully explained (and what we quoted from him on pages 154 to 157 of the May issue), can the full significance of the effect of *quantity* on price and on power be fully appreciated.

What the union leaders have "sensed" (although probably never having thought it out in detail as Böhm-Bawerk did) has similarly been sensed in other phases of business where men have attempted to obtain massive power, to wit, by the process of aggregating or accumulating what Böhm-Bawerk calls "total utility." The men who have striven for monopoly of any kind are the men who "sensed" that control of "total utility" was far more

than the mere "product" obtained by multiplying the number of units by the marginal utility of one unit. The people, when they passed anti-monopoly laws, "sensed" the same thing, but they have never thoroughly analyzed it either.

Laws are on the statute books to protect us against monopolies, and those laws are in general vigorously enforced, but it is a regrettable fact that unions are specifically exempt in this country from monopoly laws. That exemption will eventually undo them, or undo the country.

## **Attacks In Churches On Rich Men**

Rich men are attacked by many preachers, and rather indiscriminately. Even as a boy I listened, while sitting in church, to many a "crack" at rich men, and furtively looked around at the known well-to-do in the church to see how much they had "ducked" to escape the blow, or how gloomy they might look when being publicly chided for sins associated with their being well-to-do.

It is not to be gainsaid that Scripture countenances some attacks on the rich; for example, "How hardly shall a rich man enter the kingdom of heaven. It is easier for a camel to go through a needle's eye, than for a rich man to enter into the kingdom of God" (Matthew 19:24).

As no camel can pass through the eye of a needle, the conclusion seems to follow that no rich man can attain heaven. The explanation has been given that "needle" here means the gate of a city. But there is little comfort in that, because the explanation continues that ancient city gates were narrow and that the only way that a laden camel was able to get through the "needle" or gate was by being completely unloaded. Similarly, so the idea goes, a rich man could not enter the Kingdom of Heaven unless he was unloaded of his riches. There is not much "comfort" in that for the rich who would retain their riches.

It is natural that some preachers consider the "season to be always open" for attacking the rich. Such attacks are probably sincere. The people, rich and poor, seem quietly to tolerate them. When the parishioners file out of church, the preacher shakes the hand of the rich man as cordially as the hand of the poor man. On Monday the rich man and the preacher may play golf



together, as the best of friends. They probably do not refer to the Sunday blast of the preacher.

Probably few preachers who attack the rich have candidly discussed with their rich parishioners their special sin problem—namely, that they are rich. That may be evidence that they are aware of difficulties in justifying their special attack on the rich.

The typical rich man in the United States does not consider himself a special sinner because he is rich. Our observation is to the contrary, that most rich men who have acquired their wealth themselves are confident that every dollar they own is theirs *by right* of diligence, privation, judgment, courage and risk undertaken; many of these men consider themselves "persecuted" by the law, because they have done more than others but are taxed more heavily; they think they are entitled to be still richer; and most of them are very sure of themselves. The psychological case of the rich is different, however, in a considerable number of cases, when wealth has been inherited; many of the rich-by-inheritance have a guilt complex; in some cases, the foundation for that guilt complex is a real deficiency which we shall not now go into. In other cases, these people do not understand the "economic structure" and have a guilt complex lacking a justified foundation; they have what might be called a spurious guilt-complex.

Let us consider the special sin problem of the rich.

\* \* \*

I can remember two men in a small town, in which I grew up, who went to school together, did about as well in school, who married equally nice girls, who had the same size families, had suffered from the same amount of illnesses, but one man at 70 owned eight farms and the other did not own the house in which he lived. Was the first a bigger sinner than the second, because he had become well-to-do?

One of these men, a small farmer, was a "socialist," by his own profession. He made a comfortable living; he was hostile to the rich; he was vocal about wanting their wealth to be redistributed. He was not rich himself because he was lazy and because he worked only as much as was necessary to live; in the second place, he loved positions of honor and power. He stood for election for everything to which he thought he could be elected.

This man's program for his life — his *purposeful* action — was to have prestige and power. Those are legitimate objectives.

He received his reward by being a town councilman, a church officer, a committeeman for many causes, a delegate to conventions (he *loved* conventions); etc. His name was often in print.

But this man wanted to "eat his cake and have it, too"; he wanted prestige and honor, and to be rich *in addition*. Considering the ends he had selected and the means he employed to attain his *ends* he could acquire prestige and power, but not riches. It was his own free choice. He *preferred* something else more than riches. How could he expect to get a lot of that, which his means were not suited for him to get — means consisting of "hanging around town," chatting with people, ingratiating himself with them, etc.? He was working for the power derived from prestige, rather than the power derived from wealth.

In the same town was a man with eight children, each of whom eventually inherited a 160-acre farm. This man was not in politics. He held no positions of prestige. His aims were different — hard personal labor, thrift, possession of productive land. He was seldom in town. He was not a "hail-fellow-well-met."

*Purposes* are both debatable, and not debatable. Why should a preacher consider the nonriches of the first man to be proof that his purposes — to be highly regarded and have prestige and power — were better than the purposes of the other man — to produce a lot of grain and cattle? Is the motivation to get prestige and power better than the motivation to get wealth? We see little difference in the moral merit of wanting power or wealth. We see no demerit in either desire, in itself.

Nor do we see any great merit in having no ambition for either prestige or wealth. A man may be unambitious and unproductive. The unambitious and unproductive should not expect a reward for which they have not worked—whether the reward be prestige or wealth.

He may also be a most unusual man, a true uplifter. Now in regard to the *genuine* uplifter — the man who wishes to uplift others *at his own expense*, and not at the expense of others — his position is obviously unique; he is far ahead of ordinary mortals. But there may still be a cloud over his actual performance; his high purpose may not be attained unless he is genuinely wise in the *means he employs* to be a genuine uplifter. A man with

lower aims but excellent judgment of means may accomplish more to uplift others than a man with great aims but only ordinary judgment in attaining them.

Then there is another class of men who cannot become powerful, nor rich, despite not being lazy, nor an uplifter, nor having infirm judgment. These are the men afflicted by handicaps, by lack of talents, by misfortunes, by illnesses — afflictions beyond the ordinary measure. These men, as a group, are entitled to more help, sympathy, and good will, than a man in any of the preceding groups.

\* \* \*

Let us return to the preaching preacher. Before him are, let us say, men from all of these categories. But he singles out the rich man — the man who left his eight children a farm for each — for special admonition, or maybe abuse. When that man heard the special declamation of the preacher against the rich, what may he have thought to himself? Did he take the call to repentance to heart? In the cases which we can remember, there was never any evidence of repentance or reform. All the rich quietly continued according to their regular habits.

Further, in meetings where money was being "raised" men treated the rich with respect. In none of these meetings do I remember that there were speeches attacking the rich. The "tune" was different. "Some brethren," so the speeches would go, "have been blessed by the Lord with riches." Now these brethren could profit from their good fortune by showing how thankful they were "to the Lord" for having become rich. It is inconsistent to berate a man as an extra-bad sinner if he is rich, and at another time ascribe those riches as coming "from the Lord."

There are various reasons why one man is rich and another is not; there are:

1. Differences in starting point—whether from poverty, ignorance and bad environment; or from inheritance, education, and elevating associations;
2. Differences in *native* talents;
3. Differences in "fortune"—in sickness or health; a wife with or without a big dowry; calamities or windfalls; etc.;
4. Differences in objectives in life, e.g., prestige versus wealth;

5. Differences in intensity of effort to attain the objective;
6. Differences in soundness of judgment regarding *relationship to things*;
7. Differences in obeying or not obeying the moral law—honesty versus theft; coercion versus mildness (or meekness); truthfulness versus fraud.

For the first three a man can hardly take credit or blame. Item 4 is a question of "taste" or choice, as of one man preferring position to another preferring wealth. Item 5 can hardly be held against an industrious man; if wealth is the result of extraordinary *hard work*, what is wrong about that?

Item 7 is seldom in dispute. Often the richest men are considered the most honorable and honest. (That is rather infrequently because they are better; but they are "vulnerable" because of their wealth; they can be sued easily by a discontented person; they are "more honest," then, probably because they are, perforce, more exposed and consequently more responsible.)

If some rich man is a sinner in regard to item 7, why not *discipline* him before the church board for his specific sins of coercion, theft and fraud. If he is guilty of these sins, it is a mistake to thunder against him from the pulpit, as a man might shoot into the air with a shot gun. The thing to do is to summon this rich sinner before the church Session, and charge him specifically with his sin, as a man would do with a high-powered rifle, getting his game under his gunsights. Failure to take this latter step may sometimes be proof that item 7 is not the situation, and that the attack on the rich is an aimless sport.

That leaves item 6, "differences in judgment regarding the *relationship to things*." Why are some men rich and others poor, when other things to be considered are practically identical? The answer is that some men are rich (and others not), because the calculations of the former on the relationship of men to things is better; in other words, *their judgment of present and future marginal utility* was and is more realistic than that of other men.

On every hand there are obvious cases which illustrate the consequences of soundness of judgment where marginal utility is involved:

1. In a suburban farm community, the price of cabbage for the city market may for three years have been high, and the crop, consequently, very profitable. The cause of this high price may lie outside of the cabbage situation. Maybe the lettuce, cauliflower and other leafy green vegetable crops have been in short supply and therefore, as a substitute, cabbages were in unusual demand. Farmer *A*, for the fourth year, decides to plant a greater acreage in cabbages than ever before. Maybe *B* and *C* and *D* reason similarly, and do the same. Suppose, though, that Farmer *E* mistrusts the situation. He reasons (and let us suppose correctly) that the special reasons for the lettuce, cauliflower and other shortages (which redounded to the benefit of cabbages for three years) will not recur in the fourth year; let us assume he shifts to a different crop, say, sugar beets. Suppose that in accordance with the foregoing, the supply of all leafy green vegetables turns out to be too great in the fourth year. Too great a supply will result in the price being lower, maybe disastrously so. Farmers *A*, *B*, *C* and *D* may then have a loss year. Farmer *E* may do much better, and not because he was a greater sinner. He merely judged better what the relationship of supply and demand—the relationship of men to things—would be. A community preacher in such circumstances declaiming against the prosperity of some, and lamenting the misfortunes of others, is really saying something which is meaningless and even silly.

2. Or consider the great fortunes made by people who develop new products—farm implements, automobiles, television sets, new drugs, and the like. None of these can “force” their products onto consumers. Success in these fields depends on the *free* response of consumers. Those *consumers*, unless they are nit-wits, will not buy what they do not need or do not want. If they buy, they are buying in order to promote what they consider to be their own welfare. The producers who survive are those who serve the consumer best. Those producers are the men who were most accurate in pre-appraising what the position of their product would be in the list of needs and demands of potential consumers. These are the men with unusual soundness of judgment regarding where their products would stand, in the competition

of products, in the utility scale. These men possessed sound judgment in regard to marginal utility.

Does such soundness of judgment in regard to the relationship of men to things make the man who thereby becomes prosperous a greater sinner than the man who has become poor by having been wrong in his judgment of the relationship of men to things? Such a conclusion is nonsensical.

Riches which are the result of soundness of judgment regarding the relationship of men to things are not evidence of sin or iniquity. Such riches are more "blessings from the Lord" than evidences of special sinfulness.

\* \* \*

The problem remains of the many solemn warnings in Scripture about the acquisition of riches, and of many harsh criticisms of the rich.

In the first place, as has already been noted, there are two contrary notes in Scripture: riches are sometimes considered a reward and are at other times considered to be evidence of iniquity. Under the circumstances, discrimination according to cases will be absolutely necessary.

1. Scripture condemns the pursuit of the acquisition of riches at the expense of a far-sighted sense of values—values pertaining to a full life here and now and values in relation to a life to come. "Money-madness" or "crass materialism" are systematically condemned.

2. Scripture also condemns riches acquired by fraud, coercion, theft. That condemnation was particularly appropriate in near Eastern countries. Whoever has been in the Near East will be more skeptical of the honesty with which wealth was there acquired compared to wealth acquired in Western Europe or in America.

In the Western World under competition, in free markets, under mass distribution, *prices tend to be uniform* and they are labelled and well-known. Goods are usually sold at fixed, advertised, labelled prices. Some economists condemn this as evidence of an "administered price" system, that is, as evidence of arbitrary price control by the seller. Their conclusion is woefully incorrect. Such uniformity of prices under competition is one of the very

greatest protections buyers can get. Active competition practically forces the movement of goods at uniform prices, quality and service considered.

In the Near East it is different. There is no fixed, advertised, established, uniform price. The price is determined by "bargaining skill." An asking price may be two or three times what it is reasonable to ask, and under that marketing system an unscrupulous man has a better opportunity to get rich *at the expense of others*, than in the Western economy. The uniform price of the Western world places products on the basis of competing according to merit. The "higgling price" of the Near East world keeps the price of products in the limbo of uncertainty. Only the unusually skillful and strong will systematically come out well in such markets. The wealth of rich men in the time of Christ could therefore, and should therefore, be looked upon with much greater suspicion than the wealth of a manufacturer in New York or in Chicago. Widows and orphans and the poor were natural victims in a market without established prices, but only prices determined by higgling. How can a rich manufacturer be considered in the United States to have become rich *at the expense of widows and orphans*? How could he charge more when selling to widows and orphans?

3. Finally, there is criticism in Scripture of the rich if they lived in luxury, but left the poor, *especially the unfortunate and worthy poor*, to their fate, without commiseration or assistance. This is a question of the exercise of charity. Hardness of heart toward the poor, evidenced by unwillingness to help them charitably, is unqualifiedly condemned in Scripture. Any rich man guilty of this sin should be condemned for it, and be made to bear the burden of an unfavorable public opinion. Such critiques of riches in Scripture are most certainly valid. But nondiscriminating critique today of riches and rich men is evidence of carelessness in observation and reasoning.

It would be curious, would it not, that the wish to have the good things of life, to be obtained by having wealth, were sinful in itself. It appears to be impossible to meet anyone who is honest about not wishing to have the good things of life.

## An Analysis To Show Who Gets The "Profit" From New Automation Machines

*(Continuation of analysis in March and April, 1960 issues,  
pp. 89-96 and pp. 123-128)*

### Summary Of Earlier Sections

In this series we have described, first, what automation machines are and how they save money; then we presented the question, Who gets the benefit of the savings, or the "profit," from new automation machines? We listed nine potential claimants (there may be more); it is a common phenomena in life that, if there is something to be claimed, there are people on hand to try to get it. The claimants we listed are (1) the inventor, as inventor; (2) the inventor, as a capitalist who finances his own invention; (3) capitalists, who do the financing instead of an inventor who does not have the required money; (4) the mechanics who fabricated the parts of the new machine and who helped assemble it; (5) the suppliers of raw materials; (6) the company which buys the product of the automation machine (in our illustration, an automobile company which buys engines); (7) employees of that automobile company; (8) the customers of the automobile company (namely, the buyers of automobiles); and (9) the government which will endeavor to collect more taxes, a thing in itself not necessarily bad, but subject to abuse.

We have, more or less, shown (1) how the government gets its "take"; (2) next, how the buyer of the product, the XYZ Motor Company, will need an inducement (in the form of a reduction in price) to change from hand labor to automation; then (3) how the suppliers of raw materials can unintentionally get a share of the benefits from a new machine, which they neither invented nor fabricated; and (4) how workers displaced by the new automation machine are temporarily compensated by technological unemployment payments, or in other ways. All these compensations and inducements must be recovered by the savings of the machine, and more besides.

One conclusion can be reached quickly, to wit, that the inventor will find it impossible to "hog" the benefits from his invention. If he is not careful, he may finally retain little for himself. Let us consider his problem.



He has invented a cost-reducing machine which produces, in our illustration, at a cost of \$54,000 products which previously had cost \$120,000. The saving is \$66,000. (1) The Federal government will take 52 per cent of the \$66,000 in increased income taxes. (2) The XYZ Motor Company will not buy the automation machine, or its products, unless it gets as its incentive some part of the \$66,000. (3) The displaced workers will demand compensation for their "technological unemployment," and will get a temporary participation in the \$66,000. (4) To provide an incentive to raw material suppliers to make necessary changes in their activities (whatever may be needed) an inducement will have to be offered to them in the form of higher prices; (this is significant in some cases, and insignificant in others). What will be left for Mr. Inventor, who cannot escape taxes, and who cannot avoid providing incentives to obtain necessary cooperation?

#### Patent Protection For The Inventor

The first move an inventor, whether a poor individual or a big corporation, will consider will be to obtain protection by a strong patent. This requires a patent attorney and attendant expenses. Although this is another drain on the inventor's receipts from the invention, the alternative is too unattractive, namely, of being unprotected so that anyone else can rush into production of the product for which he has not suffered the inventing expense nor even had the inventing skill.

Everything that is feasible to get patent protection will be done unless there is a secret "know-how" involved which others are unlikely to be able to discover. Then *secrecy* will be the defense mechanism of the inventor. Often secret "know-how" is better protection than patents. *Patents* and *secrecy* both have their advantages and disadvantages.

Let us assume the inventor is a poor man. Some unscrupulous person may appraise the situation as follows: (1) the product is excellent; (2) the patent is a good one; but (3) the inventor is too poor to be able to go on to the expense of protecting his patent by suing me; therefore, (4) I shall infringe his patent and get into production faster than he can; finally, (5) when he realizes his predicament he will be so discouraged that he will sell his patent to me for a modest figure. In such case, the inventor may get little for his invention labor and his other costs.

\* \* \*

It will be informative to consider the *cost of inventions* and the *justification for granting patents*.

If a young engineer is employed by someone as a service engineer; if he learns of deficiencies of the equipment; and if he thinks he can develop a machine which will do the work better and cheaper, then he has two alternatives—to reveal the idea to his employer or to do the inventing and developing himself.

If he does the former, the employer will not respond favorably unless he thinks well of the idea, and unless he will spend the money to do the necessary work to convert an idea into a piece of machinery that does what it is expected to do. That always takes time and requires skill in designing, testing, improving, getting patents, tooling to manufacture, preparing promotional literature, educating the sales force, selling old inventory first, etc. This may take a long time. Some inventions require many years to develop, even by corporations with large research and engineering staffs.

When trouble and expense are considered, an employer may not be willing to buy the invention idea from his employe. The employer may fear that competitors will soon have a similar improvement, or even better. He may be skeptical about being able to get a strong patent. He may not be so progressive as others, and may prefer to be an imitator rather than a product innovator. He may know by experience that the way of the imitator is hard, but also that the road of the innovator is very rough.

Let us assume that the inventor, because of his enthusiasm for the idea that has been born in his mind, and because his employer is not so optimistic, decides to go ahead himself to invent, to test, to patent, to manufacture, and to market. These tasks are formidable. The inventor will probably be obliged to resign his present position. If for such work he has been paid \$8,000 a year, and if it takes him three years to design, test, etc. the new product, then he will have "invested" in the new product, before a unit of it is sold, \$24,000 of "lost" salary. The earnings from the invention will have to recover this, if the inventor is not to lose money.

But if a fellow-engineer who kept his own \$8,000-a-year job can, by copying what the first man developed, get into production and sale of the new product simultaneously with the inven-

tor, the latter may never be able to recover the "lost" \$24,000 in salary. It is to prevent such pirating of ideas which have cost money to develop that patent laws have been passed. An original patent is for 17 years.

But competitors immediately work hard "to get around the patent," if possible. They call their chief engineers, and explore what is the best way to protect their own businesses. The preferred way is to design something still better, something that will do more and at a lower cost, than the new machine itself. And so the man who has a new invention may find that there is small profit in it for him (even though he has a patent), because he has drawn attention to a new product, and shown an attainable new objective, and has stimulated the thinking of others by his own invention. In a sense, every invention fertilizes additional inventions, and may be the inspiration of a series of better inventions.

Maybe it is unwise to be doctrinaire regarding what a patent law should be, and how much it should protect an inventor, so that he has more or less to himself the new field in which he has pioneered. Maybe 17 years is too long; maybe, too short. But the logic of a patent law of some kind is not debatable. If anybody can copy at once what you have invented, and so appropriate some of the fruits of your long and hard effort to himself—just by being a pirate of your ideas—then inventing will look less attractive to would-be inventors, and there will be fewer inventions. People who are opposed to patent protection are those who have little urge to invent. If they did, they would become sensitive to getting protection for their ideas against zealous competitors. Stealing other people's ideas, embodied in costly inventions, would become potentially too profitable to permit anyone to neglect an opportunity of piracy. We would all become active invention pirates. Others would do it to us; we would do it to them. And the consequence would be that the incentive to invent would be reduced.

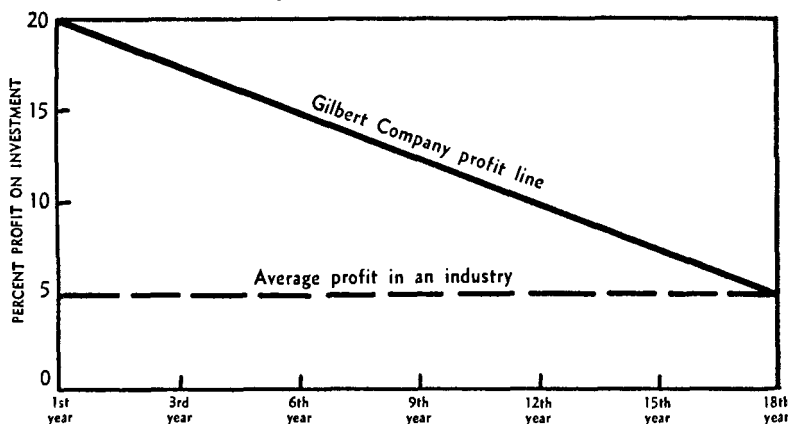
### **The Trend Of Profit Margins On New Products**

But patents are not so valuable as many people think.

Let us assume that the average profit on the investment in

an industry is 5 per cent. See the horizontal dashed line in Chart I.

**Chart I**  
**Trend Of Percentage Of Profit**  
**On Investment, When There Is A New Invention**



Let us assume next that an inventor, Gilbert, invents a machine that cuts cost so that a profit of 20 per cent on the investment can now be made. His company can at first obtain that profit. (See the beginning of the Gilbert Company profit percentage line toward the left of the chart.) But competition, stimulated by the incentive of trying to equal the Gilbert profit percentage performance, will soon develop better products than what they have had. To meet that stronger defensive competition, the Gilbert Company soon finds it necessary to reduce its prices and profit margin; the profit margin on the item will drop from 20 per cent to 19 per cent; from 19 per cent to 18 per cent; and eventually to the traditional 5 per cent. It is not a question *whether* this will happen; it is only a question of *when*. A high profit margin on a *single* new invention, no matter how high it begins, always loses ground despite strong patent protection.

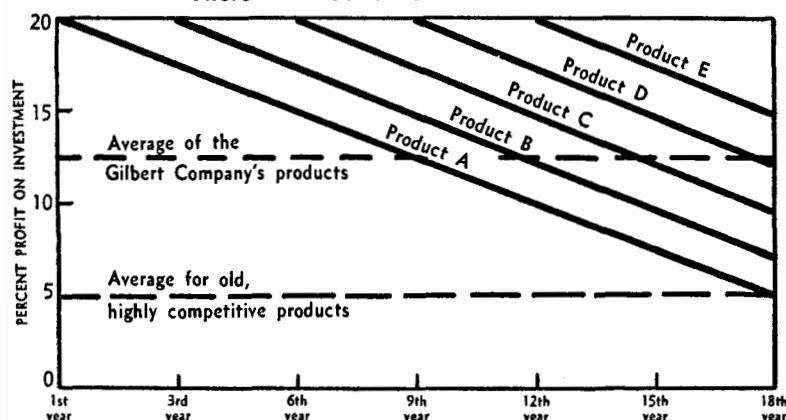
### How Investors Look At Companies Which Are Superior In Developing Inventions

The case may be looked at from an investor's viewpoint. If an investor wishes to invest in a company which has a new invention, how much of a premium should he pay for stock in the company owning the invention?

Suppose he greedily eyes the cost-saving reflected in the 20 per cent profit, which is four times the average profit in the industry; should he offer a price for the stock of the company which is four times higher, because 20 per cent is four times a 5 per cent profit? If he does, he will over-pay for the stock he buys. He should, instead of having such optimistic hopes, expect the percentage profit margin to begin to shrink quickly.

Veteran investors do not price stocks of companies with *one* new product much higher, unless (1) the invention is truly revolutionary, (2) is effectively protected by patents, and (3) is unlikely to be surpassed or circumvented. What veteran investors look for instead is the regular "habit" of developing new inventions. They are not impressed, in our dynamic economy, with the Gilbert Company having one wonderful new product. They expect the Gilbert Company's enlarged profit percentage to begin a steady decline—soon. But if, when new Product A declines to, say, a 17 per cent margin after three years, the Gilbert Company will have a second new product B which will then be a 20 per cent earner; and then, six years later, a third new product C which will earn 20 per cent; etc.; then the chart for the Gilbert Company will look like Chart II.

Chart II  
Trends Of Percentage Of Profit On Investment, When  
There Is A Series Of New Products



The average of the profit margin of the Gilbert Company can be kept high *only* by regularly injecting new high margin products into the line.

Some people—those who are complacent and wish the pace of life to be placid and easy—may lament this “spoiling” of new inventions by still better inventions, by those meanly-minded competitors. How unbrotherly business may seem to be.

### The Ultimate Beneficiary From Inventions — The Masses

But the answer to that will be obvious after some reflection. Who benefits the most by this intense competition? Surely, not the contestants. They are never more than *temporary* beneficiaries. The *permanent* beneficiaries are the masses — everybody; all the consumers. When the Gilbert Company developed something with a lower cost capable of showing a profit of 20%, it had a well-deserved temporary advantage. But a profit-margin erosion began, and the Gilbert Company had to think of reducing prices. The sequence of what happened will be obvious to whoever reflects, namely:

1. That consumers bought the new Gilbert product because it was to their advantage to do so. They consulted their *self-welfare* (or as some would say, their *selfishness*) when they acted in that manner.

2. That unless some of the cost advantage of the Gilbert Company was passed on to the consumer in the form of lower prices the Gilbert Company would not gain more volume, that is, sell more units; although its margin of profit on existing business would be improved, it would not gain volume at the expense of competitors. To gain volume it would have to reduce its price some, say 3%, and then its margin would be down to 17%. Who would benefit? The consumers. Who would be hurt? The other manufacturers who were failing to serve the consumers as well as another had demonstrated that it could be done. What will those competitors do? They will try to improve their product, and if unable to do so they will cut their margin from their traditional 5% to 2%. This is painfully lean for them, but business men struggle tenaciously to retain their volume, being motivated therein by their self-welfare.

3. That the Gilbert Company will then consider its next step, namely, to drop the price, say, another 3%, so that their margin is 14% instead of 17%. Again, the consumer is the beneficiary, and competitors are again pressed, this time still harder. Ines-

capably, they will attempt to increase their own efficiency and drop their price further; or they will discontinue producing their now competitively high-cost product. In these actions, all participants will be pursuing their own welfare to the best of their ability.

4. That the process of passing more and more to the consumer will continue until the Gilbert Company itself approaches a 5% return on its investment. But what happened to the 15% between 20% and 5%? Who got it? The masses; the consumers. It is an inevitable consequence of freedom that the great inventors benefit the masses much more than themselves. The masses, the consumers, legitimately motivated by their self-welfare, will look calculatingly at *things*, will appraise their utility, and will change their decisions according to their estimates of marginal utility for themselves.

If the Gilbert Company *regularly* invents new products which reduce costs enough so that the company retains its margin of profit on new products at 20%, how much better than 5% will its *average* return be? Presumably one-half of the difference between 5% and 20%, or  $7\frac{1}{2}\%$ . Its total return then would be  $12\frac{1}{2}\%$  rather than 5%, as is the case in the other companies. See the upper dashed line in Chart II.

### The Question Of Investment Policy

The best investment policy would then seem to be to invest in companies which are *regularly* inventing new high-margin products in order to stay ahead of competition. These are the so-called research-minded companies. And because their new products are better values, and because they encroach on the volume of the less-research-minded companies, they are the *growth* companies, which are so highly regarded. These companies by their research are constantly revolutionizing the marginal utility situation.

### Supreme Companies As Distinguished From Great Companies

But such companies—if no more than responsive to competition—are not the *very* best. The really great companies are those who have a research, invention and cost-reducing policy of *out-doing themselves*—of making their own products obsolete, of outmoding them. If they have product *A* with marvelous

qualities, they are hard at work to develop product *B* with even more marvelous qualities, which will eliminate product *A*. The really supreme companies are those which are so mindful of giving even greater values to consumers that they, in a comparative sense, destroy the excellent products they already have, and which were once marvelous compared with earlier products, but which can be made to be quite inferior by what is being developed currently.

\* \* \*

The road of the inventor, therefore, is a rugged, steep road. Every new hill that he mounts is an elevation from which he should attempt to rise even higher.

Self-satisfaction and complacency will result in an inventor quickly falling behind another who is less self-satisfied and less complacent.

The benefits to an inventor from his invention are perishable; a decline sets in almost immediately. If the inventor is a one-idea man, or so self-appreciative of *one* invention, that he is not immediately thinking of another, then he will not long have a larger-than-average return.

The benefits from an invention must be dispersed widely, or its success will be very limited.

Participants in the steps necessary to market a new product must be given an incentive—a cut in the benefits from the invention—in order to be persuaded to add their cooperation.

Finally, the consumer must get a progressively larger slice of the extra benefits *until he finally has it all*.

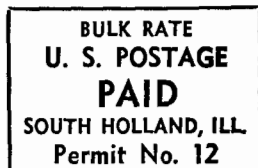
The consumer is the only *permanent* beneficiary of inventions, in a *free* market.

(To be concluded)

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Choose Your Own Physical Goals In Life From The Only Two Choices Available; and "Formal Hedonism" vs. "Contents of Hedonism"

### I

What physical objectives should men have for this life? There are two choices: (1) a pleasant physical life—life, health, prosperity for himself and his loved ones; or (2) an unpleasant physical life—sickness, misery, suffering, poverty and early death.

When presented with the two alternatives we ourselves unhesitatingly choose the first. If you choose the second, that is most certainly your privilege.

If the question is asked, which of these two does the Hebrew-Christian view of life require, then our answer is the former. If you think that the Hebrew-Christian Scriptures present to you as your proper physical goal in life sickness, poverty and misery, that again is your privilege.

But do not refuse to take a position. Do not evade the issue by piously shifting to the spiritual goals of life. Be simple and honest and take a position for once on the physical goals of life, and having taken it, stay with it.

## II

We are not acquainted with anyone who chooses sickness, misery, suffering, poverty and early death *willingly*. Christian people whom we know consider these features of life to be evils; they pray for relief from these events.

In regard to the pleasant goals of life which are mentioned in the foregoing, men are universally hedonists—they seek satisfaction and physical happiness. One of the features of hedonism that brings it into ill repute is the fact that other specific forms of hoped-for satisfactions are added to that list of goals, and those forms are appraised to be erroneous and short-sighted, or to involve unfairness to others.

Motivations consisting of "duty" or "honor" or "loyalty" do not remove the hedonistic desire for physical well-being; they may overbear it, but they do not annul it, nor really challenge it as being a desirable thing.

Men "value" good things relative to each other. When men value *honor* more than *life* or *comfort*, they do not place life and comfort in the class of evil, but only as lesser goods for them at that time and place, which should be sacrificed for greater goods.

## III

Even the worship of God is hedonistic. A reward is promised for worshipping the true God "in spirit and in truth." If the ultimate reward of worshipping God "in spirit and in truth" would be lack of satisfaction and happiness, it would be inconceivable that anyone would accept or practice such a religion.

(1) True religion is an eternal and transcendental hedonism. (2) Morality is far-sighted and wise hedonism. (3) Immorality is opportunistic and contrary-to-purpose hedonism. But everything in life is a form of hedonism—a search for satisfaction or supposed happiness. The idea that there could be nonstriving for satisfaction or happiness is unrealistic. It is only a question whether one is a good or bad hedonist.

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In our view none, except those who are "irrational," doubt that certain fundamental physical goods are always worth desiring—life, health, strength, comfort, prosperity.

Nobody then should be indifferent to what economics teaches about getting the good things in life. In that sense, economics is a practical science.

#### IV

Although confident of the correctness of the foregoing, we had misgivings about publishing it, because of the ill fame of hedonism, or even of eudaemonism. (Hedonism has come to mean the desire for dubious and wicked pleasures; and eudaemonism, as the desire for refined and noble pleasures, but pleasures nevertheless.)

Since writing the foregoing we have read the first essay in a recently translated book of Ludwig von Mises, which carries the English title, *Epistemological Problems in Economics* (D. Van Nostrand Company, Inc., Princeton, New Jersey, 1960). Mises makes a significant distinction in this book, and if that distinction is understood, then the validity of hedonism as a principle will not be disputed, nor will there be conflict between hedonism and Christianity, or any other moral system preaching love of God, duty, honor, loyalty, mercy, charity, or some other virtue. However, the distinction which it is necessary to make, in order to understand that, does not seem to be readily grasped.

In mathematics 2 plus 2 equals 4. We have never heard that disputed. We say therefore that *in principle* and *in the abstract*, 2 plus 2 *always* equals 4.

But 2 cows plus 2 horses do not equal either 4 cows or 4 horses. The formal principles of addition have not changed in this case, but the contents of the addition have; it is something other than the principle which is wrong. Change the "content" to 2 cows plus 2 cows and then the conclusion of 4 cows is correct. Erroneously endeavoring to add horses and cows no more challenges the formal rules of addition, than having unwise hedonistic motivations challenges the fact that we must have motivations, and that those motivations may be as wrong as adding cows and horses, but also as right as adding cows only.

Mises in the section of the book that we shall quote is writing about *human action* of any kind. Why do we act? Because

we *want* something. If we had no want of any kind, we would continue genuinely inactive, *motionless*. We would not flicker an eyelid, we would not breathe, we would not eat; we would be perfectly inert.

Mises writes on page 52 as follows:

None of the objections that have been raised for thousands of years against hedonism and utilitarianism has the least bearing upon the theory of action. When the [related] concepts of pleasure and pain, or utility and disutility, are grasped in their formal sense and are deprived of all material content, all the objections that have been repeated *ad nauseam* for ages have the ground cut from under them. It requires a considerable unfamiliarity with the present state of the argument to raise once again the old charges against "immoral" hedonism and "vulgar" utilitarianism.

Mises writes: "When the [related] concepts of pleasure and pain, or utility and disutility, are grasped in their *formal* sense and are *deprived of all material content*," that is, when one distinguishes principles from facts, and knows the difference between what is *formal* and what are *contents*, then one can know what it is all about.

## V

That point is different from—and better than—the point we made in the first section of this article. In order to "defend" hedonism we referred to indisputably good *contents* for hedonism—life, health and prosperity for self and loved ones (in contrast to sickness, misery, suffering, poverty and early death). We were endeavoring to substantiate that some forms of hedonism are indeed good. We were writing about the *content* of hedonism. But Mises's distinction is of a better caliber. He is writing about the *formal* aspect of hedonism, not about any specific *content* at all; he is talking merely that 2 plus 2 equals 4.

It is that *formal* aspect of propositions relative to hedonism that appears to be so difficult to apprehend.

Mises later writes (on page 57):

... When science speaks of pleasure, happiness, utility or wants, these signify nothing but what is desired, wished for and aimed at, what men regard as ends and goals, what they lack, and what, if procured, satisfies them. These terms make no reference whatever to the concrete content of what is desired: the science is formal and neutral with regard to values. The one declaration of the science of "happiness" is that it is purely subjective. In this declaration there is, therefore, room for all conceivable desires and wants. Consequently, no statement about the quality of the ends aimed at by men can in any way affect or undermine the correctness of our theory.

## VI

Because the words, pleasure and happiness, are ambiguous, any formulation of hedonism in a proposition such as, the purpose of life is happiness, is subject to objections which are based on confusion of form with content.

The problem is to find a better way to express the real idea in the foregoing proposition. Mises has formulated several variations of it which are superior. In his *Theory and History* (Yale University Press, New Haven, 1957), he wrote (our italics):

In the strict sense of the term, acting man aims only at one ultimate end, at *the attainment of a state of affairs that suits him better than the alternatives.*

Later, on page 20, he wrote:

Guided by his valuations, man is intent upon *substituting conditions that please him better for conditions which he deems less satisfactory.*

The words which are bugaboos for the anti-hedonists, to wit, happiness and pleasure, have been left out of these formulations.

These quotations come as close to the formulation *in the abstract* of the motivation for human action, as the expression, 2 plus 2 equals 4, is abstract in mathematics. Nothing more has been expressed than this, that men act according to what they think will suit them better rather than according to what they think will suit them less.

Such is the least ambiguous statement of hedonism in the formal sense.

## VII

All hedonism, in that formal sense, is unchallengeable. Life is meaningless without *formal hedonism*.

But the *content of hedonism* is another subject entirely. That content can be (1) bad, (2) neutral, a sort of adiaphora, or (3) good.

In the first section of this article we listed certain contents of hedonism which (in our opinion) are always good. The contents of *our* hedonism in FIRST PRINCIPLES, that is, our goals, are those of the Hebrew-Christian religion.

## The Great Man Whose Refrain Was, "Our Costs Are Too High"

The purpose of every invention and of every true capitalistic endeavor is to *reduce costs*. This can be in the form of a

better product for the same cost; or the same product for less cost. The quintessence of the spirit of capitalism is *economy*, that is, *more product for less cost*.

\* \* \*

Last December a great American business man\* died in Los Altos, California, after a retirement of more than 10 years from an executive position in one of the largest corporations in America. This man came as close to "perfect soundness of judgment" as any business man with whom I have ever been closely associated.

That soundness of judgment was not the product of quickness or cleverness of mind, but of two quite different characteristics, namely, (1) soundness of *principles* and (2) excellency of intellectual *method*. The first of these conformed to what Scripture teaches regarding wisdom, namely, that it consists in uniformly conforming to ethical rules, but Clithero did so on the ground of reason rather than scriptural authority. The second foundation for his remarkable soundness of judgment consisted of a self-developed method of solving problems. This method consisted of tireless fact-finding, perfectionist thoroughness, indefatigable labor, callous scepticism of mere affirmations, rejection of rhetoric or flattery as substitutes for logic, and cynicism about talk which might cover self-deception or dishonesty. As is true of great men generally, Clithero had developed his own unique method of analysis to the point that it was finally automatic with him.

Ten years of employment, in a giant industrial corporation, mostly under the personal direction of this man, was an education in itself. But it took a long time for a youth with my inexperience to discover for what kind of a man he was working. One of the expressions of Clithero which long failed to "register" on my mind was the statement (repeated almost as a refrain), *Our costs are too high*.

At first, I really failed to *note* what he said; then I resented it; next I became aware of its validity in a specific case in question; and eventually I came to see it as one formulation of the only solution of the most fundamental problem in *this* life — namely, genuinely *economic* living, that is, less costs to get a given result; less labor to get a given reward; a "reduction" in cost by giving something more useful, more long-lasting, more

\*William Scott Clithero, (1883-1959)

beautiful for the same cost and price—in short, a higher standard of living.

Nothing constitutes an earthly *gain* which does not give more for the same cost, or give the same for less cost. Here was a man without theoretical training in economics, and a man with no extraordinary interest in uplifting others, who continued to endeavor to help society by urging reduction in costs in order to save manpower and investment—although he was initially motivated to make a profit for the company.

As was made clear on pages 184-192 of the June issue of *FIRST PRINCIPLES*, the "profit" from an automation machine must stem from one source only—its *reduction of costs*; and, further, that no inventor or "cutter of costs" of any type can retain the special "advantage" of that cost-cutting *for very long*.

The refrain, *Our costs are too high*, is the refrain that every human being who wishes to help himself *temporarily*, and his fellow men *permanently*, should continue to iterate to himself, and accept as the principle by which he is living.

The poor nations of the world are the nations which lack people who have kept saying to themselves, *Our costs are too high*. Therefore, they continue to work by "main strength and awkwardness"—by hard and wearying physical labor, which in capitalistic countries is done with far less cost of personal fatigue.

The higher standard of living in capitalistic countries is largely due to the "cost-cutting" of men as Clithero, whose vision has permitted the working man—no, no, the *members of society generally*—to get *all* the benefit from the cost-cutting *eventually*, with only a temporary extra return to the innovator, the man who "cut costs"—that is, the man who put himself in the position of being able, under the pressure of competition, to "give away" to consumers the benefit of his having cut his costs.

\* \* \*

*Cost-cutting* does not consist in penny-pinching only, although most of the great business men that the world has produced were "tight" operators. They acquired that habit in the years they were "struggling"; but once having learned (the hard way) the necessity of operating by that method, they were unable and unwilling to un-learn it when they had become successful and rich.

Cost-cutting did not consist for these men in grinding down

suppliers or employees. It consisted mostly in better plans, wiser supervision, better design of products, elimination of unnecessary activities. These men attacked the structure of costs as well as the administration of costs. And always *capital* was employed as an instrument to lower costs. Indeed, it is acknowledged that, at first, such new capital yielded an extraordinary return to the owners. But as was explained in the June issue, the basic scheme of operation in a free, capitalist society, is to diffuse every new and extraordinary benefit over all men.

Noncapitalist societies have the very poor and the very rich. Capitalist societies reduce extremes—inevitably, inexorably, steadily. Capitalist societies raise the very poor to a much better standard of living. A huge middle class develops. The rich are *relatively* few.

\* \* \*

Any man who aspires to be a great business man can become one, if he intelligently goes to work on producing what is better for less cost. Have you tried that approach in your business, in your household? One of the last strongholds of inefficiency—of high costs—is the operation of a typical household.

## **An Analysis To Show Who Gets The "Profit" From New Automation Machines**

*(Final Installment)*

This is the fourth and final installment of an analysis regarding who may be, and are likely to be, the ultimate beneficiaries of the invention of a new automation machine, which has the merit that it reduces costs. Much more could be written than these four articles contain, but they should serve for the time being.

\* \* \*

Let us assume a corporation buys newly invented hosiery-weaving machines, fifty percent faster and better than ever before available. (Such are not exactly automation machines, but there will be more variety in the presentation if various inventions are taken as illustrations.) Let us assume further that the employees operating the old machines were paid on a piece rate of \$1 per dozen produced, and let us also assume that at that piece rate they could average to earn \$3 an hour (or \$120 for



a 40-hour week) on the old machine. At the old piece rate, operators can earn, while operating new machines, \$4.50 an hour, or \$180 a week.

The new, high-speed machines will (unless prices of hosiery are reduced thereby stimulating consumption) displace operators. Instead of there being, say, 90 men to operate the old machines, the company will eventually have only 60 men operating the new machines, because the 60 can produce as much as the 90 formerly produced. As was indicated in the April issue, pages 123-125, the men who are no longer needed may get a special dismissal wage, or "technological unemployment compensation," whatever it may be called, but then (sooner or later) they will "be on their own" and will have to find other jobs, and will do so.

The reason why the 30 cannot continue to work at their old employment is because of *marginal utility*. If all 90 continued to work at producing the product of these new machines, i.e., women's full-fashioned hosiery, then there will be more hosiery for sale than women will buy, at the old unreduced price.

The women, who consume hose, are distributing their purchasing power over 1001 things that women want. Every dollar of purchasing power that women have for spending has many potential uses—to buy new hats, new hair-dos, a holiday, new furniture, new jewelry, more concerts, etc. Every item is fighting for a place within the marginal utility of a woman's purchasing power. These items fighting for a place are inside or outside of that woman's marginal utility. The fact that a new invention permits 50 per cent more hosiery to be knit with an unchanged number of machine operators means nothing to women thinking hard to get the most satisfaction out of the expenditure of their marginal—their last available—dollar, *unless the price of full-fashioned hosiery is reduced*. Then madam may buy more full-fashioned hosiery than previously. But if the price is not reduced, she will not buy extra hose, merely because somebody has invented a new and faster full-fashioned hosiery machine.

The assumption according to which we are reasoning is that the price of hose is not reduced, but that the inventor of the machines, and the manufacturer who bought them, wish to get a maximum return out of the situation *for themselves*. At the moment we are leaving consumer benefits out of consideration, al-

though as was shown in the preceding issue (pages 187-192) the consumer—in this case, Mrs. Public—is *always* the *ultimate* and sole beneficiary of new inventions and of capital investment, if they come into being in a free market society. As the problem is now being posed, we wish to see who else can and will try to participate in the cost-savings obtainable from the new machine, before those savings can go to the consumer, and who, in fact, will struggle to prevent the savings ever going eventually to the consumer.

#### **The Most Aggressive Claimants To The Benefits Of New Machines**

A group of claimants which we have not considered consists of *the surviving operators working at the new machines*, the 60 in our illustration. Will they claim the benefit from the new invention? If so, that claim will naturally manifest itself in a refusal to let the labor rate per dozen be lowered. The surviving operators will say: "The old piece rate of \$1 a dozen may not be lowered." In other words, they will be saying: "It is *we* who demand the full benefit of the new invention." Or in still other words: "We are denying the inventor an inventor's reward, because the benefit is all in the labor saving, and we want that for ourselves. Furthermore, although our employer had to invest more money in this faster machine, he is not to get a reward for his larger investment, because then he would have to get that reward by our allowing him to negotiate somewhat lower piece rates. Nor do we want the price of women's full-fashioned hosiery to be lowered, because if the price is lowered as much as the cost-saving, if, in other words, the consumer is to get it all, then we cannot retain the profit from these machines for ourselves, whereas we want it all. What we ask is that you leave the piece rate unchanged."

The fact is that in the United States that proposition is almost universally accepted. It is usually phrased in this manner: *the benefit of technological improvements should go to labor*. (Note that this is different from saying "to the consumer.")

The labor unions insist on the foregoing principle as a justification for getting higher wages. Nearly all have heard of the *Annual Three Percent Improvement Factor* in the so-called efficiency of labor. And who should get that? The answer given is:

the employees working at the machines. But where does the Annual Three Percent Improvement Factor originate? Are the employees working three percent harder every year? To the contrary, the onerousness—the burdensomeness—of work is steadily being reduced. There is one and only one source of this Annual Three Percent Improvement Factor, namely, new inventions or improved machines, or at least, more machines per man. Labor does not create the "improvement factor"; capital creates it.

What the labor unions demand—that the full Annual Three Percent Improvement Factor accrue to labor—is the same thing as saying, "We operators of the new machines claim the total gain from the new machines for ourselves ONLY. None of it is to go to the inventor, to the displaced employees, to the employer, to the suppliers, or to the consumer."

We see nothing wrong with the *wish* to get that gain, but there is much to be said against the *demand* to get that gain, and there is much to be said against the public accepting the proposition that the Annual Three Percent Improvement Factor should go to the operators of machines rather than the consumer.

Here is a new invention. It is one thing for the machine to be ringed by eager, would-be beneficiaries. In fact, it is ringed by such people—inventors, capitalists, employees, consumers. To want the benefit is one thing; the *moral* question is: by what device will each of these claimants endeavor to retain or participate in the benefits? The inventor can retain the benefit as long as he has unbreakable and limitless patents; the capitalist can retain the benefit as long as he has a monopoly; the union can retain the benefit for its members as long as it has a closed or union shop (that is, a *labor* monopoly).

Contrarily, the "unorganized" *consumers* can hardly develop a coercive method. They are apparently in the weakest position. (In fact, however, they are ultimately in the strongest position, for the reason that economic law is *irresistible*, and cannot be frustrated finally by any union power, by any capitalist monopoly, nor by any patent rights. Economic *law* is as supreme ultimately, as natural law is supreme in its field.)

### The Issues Involved

1. How much *will* the surviving machine operators eventu-

ally get of the benefits of the new machines? The answer is: a little; not much.

2. How much *should* the surviving machine operators eventually get of the benefits of the new machines? The answer is: a little; not much.

3. What *method* may any claimant—the machine operators included—employ to get a “share” of the benefits of the new machine?

4. Is the demand for the Annual Three Percent Improvement Factor, by labor unions, reconcilable with the ethics of the Hebrew-Christian religions, which require that Thou shalt love thy neighbor as thyself?

These questions will be answered in reverse order.

#### Is The Demand For The Three Percent Improvement Factor Reconcilable With Loving The Neighbor?

The answer is NO, to the question whether the *demand* of the labor unions to the Annual Three Percent Improvement Factor is reconcilable with “loving the neighbor as thyself,” as the Hebrew-Christian religion requires.

The Annual Three Percent Improvement Factor is presently taken by unions as the *average* improvement factor based on increases in capital equipment available. It is realized that some machines will show a larger percentage improvement factor, but others none. The *three* percent may not be exactly right, but it is considered to be the improvement spread over the whole mass of operators of machines. If the improvement would increase to 4% on the average, the demand would be raised to 4%. If the improvement would decline to 2% on the average, the demand would (presumably) be reduced to 2%. It is not feasible for unions to make their claims by specific machines and specific machine operators. That would introduce a complexity, and discrimination in favor of employees lucky enough to work on newly invented machines. The 3% is supposed to gather in *all* the gains by invention, capital improvement and additions per operator. In short, the benefits of new inventions and the expansion of capitalism are to go to *some* of the workers (those in the unions) rather than to *all* of the consumers.

In the previous analyses it was shown that *temporarily* this or that claimant—inventor, capitalist, etc.—would share as bene-

ficiaries, but that eventually the consumer would be the sole beneficiary. But the Annual Three Percent Improvement Factor is a principle that involves that the consumer will *never* get the ultimate benefit, but that the operators of the machines will. The benefits are to be frozen in the Annual Three Percent Improvement Factor wage increase.

This proposal violates Hebrew-Christian ethics in two respects, (1) it limits "neighbors" to one class, excluding others; and (2) it relies on compulsion, in violation of the Sixth Commandment of the Decalogue, *Thou shalt not coerce*.

The *consumers* are everybody; the consumers, as was shown in the previous issue, would get all the benefits eventually from invention and capitalism in a *free market*. The reason for that is that patents expire, competitors copy, and everybody in business struggles to keep close to the leaders. The mechanism by which such benefits accrue to the consumer are lower prices, as a result of competition. In the situation which is being considered, prices cannot be lowered to the consumer, because the savings from the new machines have been impounded by the operators of the machines in the form of higher wages.

The people, therefore, who favor the Annual Three Percent Improvement Factor as the basis for the wage policy, are people who say in effect, "Not everybody is my neighbor, but only my fellow producers, and of course I share with them." If there are others who favor this scheme of things, they are confused.

There is a famous incident mentioned in the New Testament. The first question posed was: What does it mean to love the neighbor as the self? But the second question followed hard upon the first, and it was: And *who is my neighbor?* To that question, the answer in parable form was: *everybody*. (See the Parable of the Good Samaritan.) The Annual Three Percent Improvement Factor involves a contradiction to that principle.

The Annual Three Percent Improvement Factor involves another unethical principle; it involves compulsion. The unions would be able to obtain for their members little of the Annual Three Percent Improvement Factor if they did not dispose over improper power and coercion by means of strikes, threats, and massive control over the marginal utility of labor, as was explained on pages 174-176 of the June issue. The law specifically

allows monopoly power to labor unions. It is because of those monopoly powers that unions can temporarily impound, for their members only, the Annual Three Percent Improvement Factor, with nothing left for the rest. (Their purpose of course is to impound it permanently, which is a program doomed to failure.)

That such *coercion* is a violation of the Decalogue has been presented in earlier issues, and should not take up more attention in this connection.

*How* will consumers benefit if union monopoly power is not permitted to become operative? By *lower prices*. If the Annual Improvement Factor is three percent, then prices would (if all other things were equal) drop steadily. The standard of living would go up because prices would be declining faster than wages. The alternative, which the people of the United States have chosen (under the influence of unwise leaders), is to increase labor rates 3% to one group. Actually, how all this is finally distributed becomes complex, but the unchallengeable general conclusion that must be reached is that, *in principle coercion is wrong in a good society*. That adverse judgment must be accepted, or coercion will eventually destroy a good society.

#### **What Method May A Claimant Employ To Get A Share Of The Benefits Of A New Machine?**

But the foregoing union critique of coercion is not readily accepted. A rejoinder is expressed in this manner: The big grind down the small; the rich grind down the weak; the employer grinds down the employee. Every trade, every contract, every transaction involves coercion *of a sort*. The man in a strong position can out-trade the man in a weak position.

For the purpose of analysis only, let us grant it. The "strong" man, in this case, is the employer or the capitalist. Will he be able to retain the benefits of the new machine? Those who advance that argument are they who do not know about or who reject the facts of life in business, as those were outlined in the text and charts on pages 187-192 of the previous issue. The so-called strong *cannot* retain the benefits of new inventions.

It is the inability of some to see beyond the obvious which prevents them from reasoning lucidly. A case in point is Beatrice Webb, who with her husband Sidney Webb, greatly damaged

the welfare of the people of England by seducing many of them to accept the ideas of socialism.

Beatrice was the daughter of a wealthy and powerful business tycoon. Beatrice, whom the Creator had apparently decided to leave naive, observed with shock and disapproval how her father operated. He ran his business like an emperor. His employees feared (respected?) him. They were afraid to contradict him. Her father acted like and seemed to be a perfect dictator, an evil actor who should be deprived of being so powerful, and high-handed, and with such capacity of making himself respected. What poor Beatrice did not see, and was apparently not blessed with the perspicacity to see, was that papa might be master of his house, and master of his employees in a sense, but that in the final analysis he was *not a free agent*, but a subordinate of his customers. Yes, Beatrice's father "ran" the company; but the customers of the company "ran" Beatrice's father. Beatrice suffered from the hallucination that her father was doing what he arbitrarily pleased to be doing; that he was really irresponsible; that he represented autonomous power.

But that view is a most defective one. Let Beatrice's papa but set his prices too high; or produce poor merchandise; or give poor service; or let his labor cost get too high, and his days of power and prestige will be over. Mr. and Mrs. Consumer will bring Beatrice's papa to time fast.

But what about the poor employees of Beatrice's papa? Did papa not grind them down into poverty? Suppose he paid less wages than others. Would not the employees leave? Or if they were "too weak" to leave because of family obligations, etc., would not Beatrice's papa soon have trouble getting new help because new employees would go to work elsewhere where the wages were better? Papa would soon be short of necessary labor, if he treated employees worse than the marginal utility of labor required. And then Beatrice's papa would be *forced* to raise his wages in order either not to lose help, or in order to gain help.

In many businesses deferential respect is shown to the big executives in it. They may think they are "big shots," but really they are little fellows. True, they may tragically suffer the same hallucinations about themselves, that Beatrice suffered about her

own papa. But it is hopeless to try to remove all the hallucinations of the naive folk who live in the world.

Behind the idea that business tycoons can be arbitrary with customers or employees lies a whole series of defective observations and fallacies which it is not appropriate to cover at this point.

#### How Much Should The Surviving Machine Operators Get Of The Benefits Of The New Machine?

The assumption underlying this question is that the surviving machine operators will not be able to demand all the benefits from the new machine, and also that they will not be living in an atmosphere which concedes the principle underlying the expression, Three Percent Annual Improvement Factor. What will these operators get in a *free market*? Will they get nothing?

They will certainly get something. The purpose of the new machine was to cut costs, and not to subsidize the Annual Three Percent Improvement Factor. The companies that cut costs are the best-managed companies. By cutting costs they put themselves in a position to cut prices. By cutting prices they can sell more. When they sell more, they need more employees. When they need more employees, they cannot pay less than the market price for labor, or just the market price for labor. To entice employees away from other employers, and to induce new entrants into the labor market to come to their shops, the *competent employers* (who are also always in the front technological) *offer to pay more wages than the prevailing market rate*. Therefore, the surviving operators will get "their share" of the benefits of the new invention, because their cooperation is needed, and must be purchased in the open market where marginal utility reigns supreme.

It will be obvious from the foregoing that the machine operator is no more forgotten than the inventor, or the capitalist, or the consumer, or the raw material supplier. He is subject to the same laws that benefit them and the same laws that restrict them. The strictures which are determined by the fact that there is a *universal welfareshortage* do pinch him. But no more than others. It is foolish to argue against what is designated by the term, *universal welfareshortage*; it is equivalent to arguing against creation, nature, and God.



### How Much Will The Surviving Machine Operators Get Of The Benefits Of New Machines?

Behind this question lies the assumption that the operators will temporarily enforce their Annual Three Percent Improvement Factor. The conclusion might then be: "Well, they have coercive power; if they have that, then they will get the full benefit derived from the new machines; neither inventor, nor capitalist, nor the consumers will get it; that's that."

But such an answer assumes that there is no such thing as *economic law*, or more clearly, *economic LAW*.

The fact is that the unions do *not* get what they declare they want, and what they declare they are entitled to. They get only a fraction of what they set out to get. Temporarily, they get, by labor monopoly, that is, by coercion, more than they would get in a free market, and more than they are entitled to morally, but right behind them is a Nemesis, a goddess of retribution, who will exact compensatory justice, and will eventually remove the advantages gained by coercion.

The avenging nemesis takes three forms: (1) others are injured as much by the coercive hogging of gains by union members as they gain; Peter is robbed to pay Paul; or (2) there is chronic unemployment; or (3) there is inflationism. The magnitudes of these evils are in the order mentioned; the first is the least; the second is worse; the third is worst. Fifty years ago we had the first; in the 1930s we had the second; at the present time we have the third. We have gone from bad to worse, and from worse to worst.

(1) The original labor movement was a craft movement, that is, it was an organization of skilled workers only, with the unskilled kept out as though they were pariahs. As the skilled, by union organization or more accurately by union coercion, raised their rates of pay, the nonskilled, nonorganized, nonpowerful workers received that much less. But when John Lewis came along with the idea of omnibus unions to include all wage earners, and eventually nearly everybody, the number of the victims was reduced. Originally, the victims had included all except the organized, skilled workers; the rest consisted of everybody else—the unskilled, farmers, office help, professional people, etc.; but especially the unskilled. With more and more groups being organ-

ized into unions, only a shrinking number of residual, unorganized folk are the victims. The tendency, for example, of teachers' and ministers' salaries to lag behind the increase in general wage rates is notorious. Go to a meeting; the poorest car there probably belongs to the preacher.

(2) In the 1930s when the union movement had become so inclusive among wage earners that the victims of union pressure for higher labor rates had about been restricted to the nonwage-earning population, the consequence of union coercion was chronic unemployment. Labor rates were held too high by the unions to permit the slower and less-productive workers to be employed profitably. They became unemployed. And not only that, but *chronically* unemployed. The structure of prices versus wage rates prohibited hiring the less-productive. As chronic unemployment is nerve-racking and frustrating, it is politically unfeasible. It was only a question of time before it would be abandoned for something that appeared to be a nerve sedative rather than a nerve irritator.

(3) The next form in which the unsound policy of reserving to labor union members the bulk of the benefits from inventions and advances in capitalism has proved, as might be expected, to be inflationism. This is a big subject, but the system has been working in the United States as follows:

- (a) Labor rates are forced up on the ground that labor should get the Annual Three Percent Improvement Factor increase (an increase which, however, stems from capital and not from labor).
- (b) To avoid products, therefore, not being salable, because the consumers do not have enough money to buy the products with this steadily augmenting labor cost in it, the monetary authorities have been steadily increasing the amount of money. This has permitted price increases, thereby eliminating unemployment. If this additional money were not made available, prices could not increase, and then we would be back to chronic unemployment. And so it is the official policy of the United States people and government to accept the principle of manufacturing more and more money in order to avoid chronic unemployment, or as it is expressed in positive terms, to promote full employment. This

means all the instabilities and injustices that inflationism involves.

- (c) But the wrath of God—or if you will, the laws of economics—or as others might say, ineluctable cause and effect—will eventually “catch up” with this mischief. What happens will depend on who “sins” the faster, we or foreign nations. If we inflate slower than they do; if they sin faster than we do, this mischief can go on a long time at the expense of those citizens who do not know how to “hedge against inflation.” (On how to do so, see *FIRST PRINCIPLES*, June, 1958, pages 167-171.) But if we inflate faster (under a pressure that our laws have deliberately permitted to labor unions), then we will lose our export markets, we will be disturbed with more imports than exports, we will lose gold, we will have chronic unemployment again, etc. In short, we have not found, and we never shall find, a method of being unsound in our domestic policies, or in ethical terms, we will *never* find a way to sin in a penalty-less manner. The ages give us no precedent to encourage us on that, and logic warns us of inescapable, undesirable consequences. Our “sins *will* find us out.”

\* \* \*

It is appropriate, therefore, to state a general conclusion: *Instead of the proposition that the benefits of technological improvements should go exclusively (or even predominantly) to machine operators and remain there, the contrary proposition should be accepted, to wit, the benefit of technological improvements should temporarily be distributed to all the participants whose cooperation is necessary, but should be left to go, by the course determined by active competition in free markets, to the only proper eventual and ultimate beneficiaries, namely, consumers.*

No government, no church, no individual will ever *d-i-s-t-r-i-b-u-t-e* the benefits derivable from the deeds of inventors and the savings of investors as well as competition will distribute those benefits, if competition is only left to function unhindered.

The real causal factor, underlying the *distribution of benefits*, and operating under the name of competition, is that ineradicable self-love which all men have as a gift of creation. The consequence is that the legitimate pursuit of self-welfare, an in-

clination created by God in men, *binds men together by the laws which determine the relations of men to goods*. Those relations are described and illuminated by the Laws of Marginal Utility. Society cannot be examined analytically except the researcher has a thorough understanding of marginal utility.

To try to understand society without understanding marginal utility is like trying to learn to read without being willing to learn the alphabet.

## The Question Of The Legitimacy Of Five Percent Interest

Profit varies; for one man or one company it may be high; for another man and another company it may be low, or even nonexistent.

Almost always the most profitable companies pay the highest wages; and the least profitable companies, the lowest wages. Profit then does not ordinarily depend on exploitation of the workers. If that were true, then the wages in the most successful companies would be the lowest.

When the question is asked: what is the average profitability of companies, it is not possible to give an exact answer. Probably it is somewhere between 3% and 6% on the invested capital. The percentage will vary in different parts of the world, and may be much higher in very poor economies. Arbitrarily, we have selected 5% as the average return on the invested capital, or net worth, of a business. That means that if you invest \$100 in a business, you will have \$105 at the end of the year. You can take out the \$5 and spend it, or you can leave it in the business. And so, on the average, year-in and year-out you may earn 5%.

This percentage return on capital, or on money loaned, goes by various names, *profit* or *earnings*, *interest*, *discount*, *rent*. The terminology is confusing and therefore unfortunate.

(1) *Interest* usually refers to the return on, or income derived from, money loaned. The percentage does not fluctuate greatly.

(2) *Profit* or *earnings* refer to the gain from being in business. (Instead of a gain, there is often a *loss*.) The profit or loss gyrates up and down disconcertingly to nearly all people ex-

cept those who have a good perspective of what is going on. (A *dividend* is the part of the current or past earnings paid out at a given time.)

(3) *Discount* mostly refers to the same thing that *interest* does as was explained in the foregoing. It is a term used more by bankers than by others. The public seldom uses the term, and does not generally understand it. In the grade schools the children are taught that "bank discount" is a neat way by which bankers can collect more interest, by taking the interest they want on their money out of the principal of the loan before they make it. As is true of many things in life, this is an apparent truth which fails to illuminate the subject adequately, although a full understanding of it would be valuable.

(4) *Rent* is the return on land and fixed improvements on land.

In addition, all four terms (interest, profit, discount and rent) are grouped, in theoretical economics, under the one term, *interest*. Interest is, therefore, a *specific* term for the income derived from loaning money, and a *generic* term for income not only from money but also from land and from any form of capital.

There are, in addition, other complications such as *gross interest* versus *net interest*. There is also the question of risk allowances, which are hidden in an interest rate; these are really disguised insurance premiums; a risky loan will require a higher interest rate than a safe loan. Then, there is a factor hidden in the interest rate which may be described as the allowance for inflation or deflation of prices.

But there remains this fundamental fact—there is a "return," an income, on capital and money. It may have several names; it may be steady or it may gyrate; it may be a single pure factor, or it may be a complex combination of return, risk, depreciation, trends, etc.; but whatever the phenomenon is called, and despite it not being sure, there is nevertheless on the average an income that is "unearned" and that accrues to the owner of capital. (Incidentally, the term "unearned income" is most unfortunate. It is impossible for interest, correctly understood, to have any connection with earnings.)

In the preceding article and in the series of which it was a part, *profit* was talked about as being variable. It was assumed

to be as high as 20% annually. But it was also declared that a profit percentage at 20% would be only temporary and unstable. It was declared that the trend would always be downward—*until the profit was about 5%, when it would level out.*

In actual life things are not so simple as that. Profits do not "settle" at 5%; the actual tendency is to fluctuate above and below that figure, usually less rather than more. There may be actual losses.

We come now to the crucial question—*Why that return?* Why not 2%? Why not 10%? Why any at all?

No answer to that question can have real meaning unless it includes in its explanation a use of the concept *marginal utility*.

In all the centuries of human history up to 1889 no satisfactory answer was found by philosophers, theologians, moralists, business men or anybody.

The "cause" for the finding of the correct answer was that for the first time in the history of mankind a man had come along who struck a blow at the very root of interest in a generic sense. That had never been done before; not by Moses or the prophets; not by the Greeks, or the Romans; not by the Roman Catholic church. Those attackers had merely been attempting to clip off some of the branches of the tree, but they never put the axe to the tree. The man who finally came upon the scene and attacked *all interest in principle*, and challenged its existence in any and every form as injustice and iniquity was Karl Marx (1818-1883). He declared that *all interest* was exploitation of the weak, and a vicious evil.

There is no real relationship between the attacks in the Hebrew-Christian Scriptures, by Greek philosophers, and by the Roman Catholic church on *interest in a specific sense*, on the one hand; and the attack of Karl Marx on *interest in a generic sense*, on the other hand. Those are distinct phenomena.

But when the Goliath against interest in a generic sense appeared on the scene, it was inevitable that a revolution was at hand in the economic world unless a David in favor of interest in a generic sense appeared to fight it out in single combat. The David who came forward at that time was Eugen von Böhm-Bawerk (1851-1914).

It is proposed in this and some of the following issues to

outline Böhm-Bawerk's analysis of the phenomena of interest in a generic sense. The term that is used to designate that kind of interest, in the English translations of Böhm-Bawerk, is *originary interest*; originary here implies primeval, fundamental, or basic interest. It refers to the *common element* in money interest, business profit, bank discount, and land and building rents.

## Theologians And The Interest Rate

It seems that the Bible condemns interest on money. At any rate, many Bible students have interpreted various remarks in the Bible in that way.

The Mother Church (Roman Catholic) for centuries disciplined its members if they accepted or paid interest.

Then there are the "trimmers," who think that truth, righteousness and peace are obtainable by a middle course; they are in favor of interest but are opposed to *excessive* interest, that is, they are opposed to what is called usury.

There is nothing in the Bible that explains where usury begins or ends. Nobody can categorically say that one rate is usury and that another is not. What the statutes of the government declare to be usury is as arbitrary as any individual man's opinion.

The use of the idea of usury should apply much more to restraining those who loan money to the imprudent, desperate and foolish, rather than to the determination of the general rate of interest for everybody. And so shifting from *interest* to *usury* is quibbling; nothing has been settled thereby.

Cautious expositors of the Bible have backed away from saying that the Bible condemns interest, despite statements that indicate that writers of some of the books of the Bible appear to reject money interest; see Exodus 22:25; Leviticus 25:36; Deuteronomy 23:19; Nehemiah 5:7; Psalm 15:5; Proverbs 28:8; Isaiah 24:2; Ezekiel 18:8, 13 and 17 and Ezekiel 22:12.

It is significant that there is no statement by Christ in the New Testament condemning interest; rather, he accepts interest as a proper phenomena in society; see Matthew 25:27 and Luke 17:23.

The Roman Catholic Church's persevering fight to enforce its view that interest was unjust, because the Bible seemed to condemn interest, ended in complete and ignominious defeat. No philosopher, no church, no state has ever been able to drive

out the paying and the receiving of interest. Only a few Biblical obscurantists still concern themselves tremulously whether the payment and acceptance of interest is sin. There is no prospect that the church, on *scriptural* grounds, will revive its opposition to interest; in that form, the problem is a dead dodo. There is, in fact, no merit to the proposition that business interest is forbidden in Scripture; see earlier issues of FIRST PRINCIPLES.

Although orthodox theologians and churches know that they have been defeated on interest, and although they probably will never revive their fight against interest, nevertheless the observation appears to be justified that they do not know *why* they were defeated. They are like a man stunned by a terrible blow, who recovers his senses, but does not have any idea of what happened and who did it. All the man knows is that he has a terrible headache. All that the devout theologians know is that they lost the fight against interest.

\* \* \*

Whether interest is something that is moral or immoral to exact from a borrower should be answerable on the basis of logic as well as on the basis of authority. The question, therefore, arises: what is the *origin* of interest? After that has been discovered, it will no longer be out of order to have the temerity to appraise it.

But Christian thinkers—the men whose thinking is determined by their adherence to Christian doctrine and required mode of living—have not, to the writer's knowledge, evinced an understanding of what the origin of interest is. Their writings give evidence of only insignificant knowledge of the economics of interest.

Several years ago, this publication offered a \$1,000 prize for a quotation of a logical explanation of the phenomenon of interest to be found in the writings of anyone connected with one of the three great branches of the Christian religion (the Calvinist). No one wrote referring us to any logical explanation of interest that they had ever seen in any writing by any man professing himself a Calvinist. The ease with which that \$1,000 could have been earned if such a document, or paragraph, or sentence existed, together with the fact that no quotation or explanation was forthcoming, is significant evidence that the origin of interest is gen-



erally unknown among Christians, or at least among Calvinists.

\* \* \*

But if the devout, Biblically minded theologians have abandoned critique of interest on any alleged ground in Scripture, the modern, rationalistic theologians who look at socialism as being the prospective Kingdom of God on earth have taken up the old fight against interest. They have read Karl Marx's writings on interest in his *Das Kapital*, or they have learned of his views second (or third) hand, and many of them accept fully or in part Marx's critique of originary interest.

The mildest form in which they express their anti-interest critique is that they say that the profits in business are too high. Or they say that prices of products should not be raised but that wages should; this is a squeeze argument—the squeeze being between selling prices and costs—which is equivalent to saying that the profits which businesses presently obtain are too high.

And so, as the attack by the old-fashioned, devout and Biblical theologians has become silent, the attack by the sophisticated, rationalistic and socialistic-minded theologians has become more vigorous.

The Bible is no longer quoted against interest, by conservative theologians. But Karl Marx is quoted, or if not quoted his ideas against interest are accepted as premises, by liberal theologians.

\* \* \*

The great furore made by Marx was about the *exploitation of the employee*. If businesses average to earn only 5% on their investment, then it is that 5% which constitutes the total of the exploitation. In that sense, the *interest rate* is a basic issue between Capitalism and Socialism.

## The Origin Of Interest

In order to endeavor to explain the origin of interest simply, four subjects will be discussed briefly:

1. The idea of marginal utility, with special reference to its significance for interest;
2. The discount by men of the future compared with the present, as a factor in marginal utility;
3. Interest as the extent of the discounting of the future, by men;

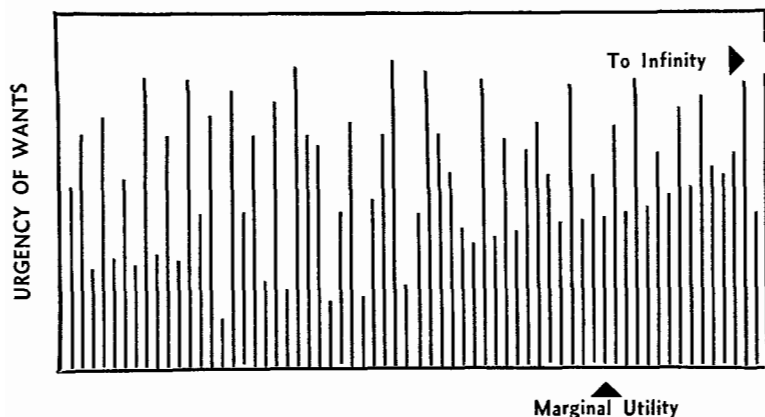
#### 4. A catalogue of fallacies about interest.

##### The Idea Of Marginal Utility

Marginal utility refers to the universal endeavor of each human being to maximize his welfare, or at least, to get the most out of life for himself according to his own set of values; or to obtain something for others, if he values something for others as worth more than the cost to himself. A man can engage in motions just for the sake of activity, as a branch of a tree waving in the wind has motion, but life has meaning in as far as it is more than that, and in as far as it has significant purpose. The purpose of a man *relative to things* is to get the most for the least. A man endeavors to maximize his welfare. Because his wants exceed what he can get, a man must (1) select what means the most for him, and (2) economize on his efforts. Each man is constantly engaging in a never-ending appraisal program. He has before him a long list of things—material, intellectual and spiritual—that he might get, and of this list he selects what he wants most, because he cannot afford to endeavor to get all that is in the list.

The columns in Chart I following designate the specific things from among which a man might select. Each bar or column represents a want, and the height represents the magnitude of the want.

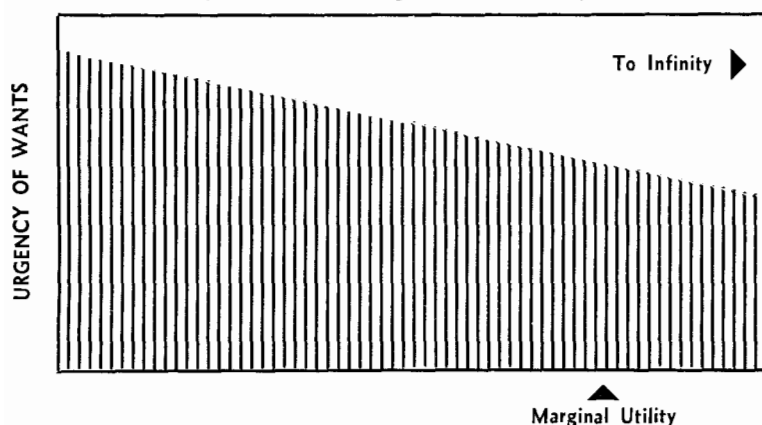
Chart I  
The Chaos Of Wants Which Motivate Men  
(Each column represents a want)



The number of wants exceeds any capability of satisfying them. But men are finite beings, disposing over limited time, strength and means. Only *some* of the items in the foregoing list can be included. Some *must* be excluded. Those destined for exclusion are those that are least-wanted.

The process by which a man decides what he is going to enjoy, and what he will have to forgo, involves the process of *ranking the wants*. The more important the satisfaction of the particular want is to him, the higher the rank he will give it. In a sense, he rearranges the bars or columns shown in Chart I so that the chart of his choices looks like Chart II.

**Chart II**  
**The Ranking Of Wants By Men**  
(Each column represents a want)



At that location in Chart II where the limit of a man's resources of acquisition are reached an arrow on the lower margin pointing upward is shown. Nothing to the right of that can be acquired because the buyer lacks the resources. Everything to the left he can buy.

A man can change the location of his marginal utility by increasing or decreasing his total ability to acquire. If he works harder, or produces and earns more, so that he can acquire more, then his marginal utility moves further to the right; or vice versa.

But a person can also change the constituency of what is to the left of his marginal utility point. Today a woman may wish

to buy a garbage disposal unit; a deep freezer; 25-years ago these items were not on her list. Today she may want an automobile of her own so that she is not restricted to staying at home, because her husband is using the family car; and, in order to reduce the investment in a second car and the operating costs, the additional car may be a compact car. In actual life these new product entrants require either that the marginal utility point be moved so that it is more inclusive, or else the new items force the removal of some other item of consumption heretofore in the list; the process is then as in a spelling bee, when one goes up another must go down in rank.

These columns do not show categories or classes of goods, but that unit-size of a good which people use in their thinking; for example, not bread as a class, but one loaf of bread (the natural acquisition unit for bread). There might be five different columns for five different loaves of bread in Chart I. When these columns for bread are ranked or sorted as in Chart II, then the first loaf may be represented by a tall column, the second by a medium-sized column, the third by a column just within (to the left of) the marginal utility point. The other two may be outside (to the right) of the marginal utility point. For that person, his way of living calls for three loaves of bread. At another time it might be four or five loaves (or even more), and at other times less than three.

Obviously, this is an unending *ranking* process, engaged in by each responsible human being, in order to regulate his life. Basically, this pattern describing reality pertains to *every kind of value* a person may have—values for himself but also for others; and values of a material, intellectual or spiritual character. But value after value jostles and jockeys for position on these illustrative charts.

At the marginal utility point the inescapable *universal welfare-shortage* sets in; at this point, finite resources fail to satisfy the insatiable, and therefore theoretically infinite, demand. What is beyond the marginal utility point for a particular individual is outside his range of consumption.

The *welfare-shortage* point is not determined by money-income only. Some values represented by the columns can be satis-

fied or attained by non-monetary expenditure, as for example, additional personal labor requiring no money outlay.

So much for marginal utility.

### The Discount By Men Of The Future Compared With The Present, As A Factor In Marginal Utility

The marginal utility figuratively presented in Chart II is affected by a time factor. Let us consider *A* and *B*. Suppose *A* very much wishes to move one of his values, reflected by a bar on the outside of the marginal utility line, to the left, that is, so that it is within the marginal utility point. But *A* lacks the resources. Suppose he goes to *B* and asks: "Will you loan me the \$100 I need so that I can get a garbage disposal unit at this time, right *now*." *B* strokes his chin and thinks hard; if he makes the loan to *A*, then the marginal utility of his own expenditures must move to the left as far as *A*'s moves to the right. Suppose that *B* decides to co-operate with *A*, but he bargains. *B* says to *A*: "You plan to buy a garbage disposal unit for that \$100. In fact, I was going to buy one myself. If I loan you the money, I shall have to wait a year before you can pay me back. To compensate me for waiting, I must get back more than \$100. I will loan you the \$100, if you will pay me back \$105, one year from now." If *A* wants the garbage disposal unit eagerly enough to pay that price, he will be able to buy today; *B* will postpone his purchase for a year. The \$5 premium that *B* demanded is remuneration for a *time* factor.

How interpret *B*'s decision to wait, on the condition that he would get \$5 as his reward? What he was really saying is this: "I am living this life only once; a garbage disposal unit will be a nice thing to have right now. If I am to wait a year I feel I should get \$105 back for the \$100 I am now lending *A* so that he can buy that garbage disposal unit for himself at once. In other words, \$100 *now* is worth more than \$100 a year from now; a good available *in the present* is worth more than the same good available *in the future*. For me that difference amounts to \$5."

Putting the proposition in the language of marginal utility, a garbage disposal unit available today at \$100 requires \$105 in the future in order that the transaction approach "equality." The equation reads: \$100 now = \$105 available a year from now. *The individual dollars in the \$105, must obviously be "smaller"*

dollars if it takes 105 of them to equal the hundred singles in the \$100 now. The future dollars have a "discount" in them. They are worth less than present dollars.

That is what originary interest, or generic interest (call it what you will), really is; it is a measurement of the discount for what is in the future compared with what is available at present. As men "discount" the future, for perfectly rational reasons (and will continue to discount the future), the phenomena of interest is ineradicable. It is in the nature of things. It will never disappear in the present dispensation.

*It will be injustice for interest ever to disappear.* That will be made clear in future issues.

#### Interest As The Extent Of The Discounting Of The Future, By Men

Different people discount the future differently. Imprudent men or those who have poor prospects for the future, discount the future greatly; prudent men discount the future less. If the prevailing originary interest rate is 5%, then that is the average or over-all figure which is determined by all men, the prudent as well as the imprudent.

Consider how circumstances will affect a man's "discounting of the future." Consider a soldier who expects to be ordered tomorrow into the front battle line. He has \$30 in his pocket. Will he value the future highly? In many cases not; he may say to himself, "On the day after tomorrow I may be dead. Those \$30 will do me no good then; therefore, *the present is what counts for me*; spend the \$30! A future in which I can spend this \$30 may not even exist for me."

Another young man, safe at home in times of peace, and very ambitious for his future, may save every dollar he can, for marriage and his career. This man, too, makes his contribution to the final, general rate for originary interest — the general rate at which the future is discounted compared to the present.

The five percent that has here been used is arbitrary. The originary interest rate varies constantly, by time, by place.

#### A Catalogue Of Fallacies About Interest

There has been a long history to the endeavor to explain the origin of interest.

1. One theory is the *productivity of capital*. This is the most obvious explanation, but it is erroneous. The socialists, as good critics, blew this argument "out of the water." But today, still, many business men, being ignorant of the socialist critique which is valid, still think that interest is justified because capital is productive. These business men are guilty of a gross fallacy.

2. Another theory is that interest is the *reward for abstinence*. Ferdinand Lassalle, the fiery socialist rabble-rouser, derided the "abstinence" explanation. He ridiculed the "painfulness" of the saving of the rich. Although rhetoric is no substitute for logic, it must be conceded that the abstinence of savers does not explain the phenomena of interest.

3. Another theory is that interest is a *compensation for use*. This theory is particularly appealing as an explanation for rent on land, rent being one of the specific forms of interest in its generic sense. This argument is that the price of land and of the use of land are two quite different things. The price of the land is what it can be sold for; the price of the use of land is the rent. Behind the latter statement there lies as subtle a fallacy as the human mind can fall into. Only someone who really understands what the great medieval scholar, William of Ockham (or Occam), had in mind when he developed his formula, *Entia non sunt multiplicandum praeter necessitatem*, will be able readily to see the basic fallacy in the use argument when it separates land from the use of land. The use argument for interest, although amazingly subtle, is nevertheless a gross fallacy.

4. Then there is the *exploitation theory* about interest. This stems from two German socialists — Rodbertus and Karl Marx. They argued that originary interest was exploitation of the employee, something snatched from him by the employer. Both put forth laborious efforts — especially Marx — to prove that originary interest is cruel exploitation; that idea might be considered to be in harmony with the argument, hinted in Scripture, of the rich exploiting the poor. To deny that there are individual cases of exploitation is to deny the obvious. But as an explanation of the phenomena of originary interest the exploitation theory is the poorest. Of all the fallacies about interest, this is the grossest.

## Mises On The Gist Of Böhm-Bawerk's Theory About Interest

One of the greatest economists in economic history, Eugen von Böhm-Bawerk, wrote a three-volume work with the title, *Capital and Interest*. Böhm-Bawerk declared that fundamentally interest is neither a monetary, abstinence, production, use, nor exploitation phenomenon. The evidence adduced by Böhm-Bawerk is conclusive.

Ludwig von Mises has written as follows:

The gist of Böhm-Bawerk's theory is the cognition that interest is *not* the specific income derived from the utilization of capital goods.

If interest is basically neither a monetary, abstinence, production, use, nor exploitation phenomenon, then what is it? The answer is that it is the manifestation and measurement of a *psychological* phenomenon—a discounting of the value of future goods.

Any attempt to justify interest on any other basis is doomed to failure.

Nevertheless, the idea of Böhm-Bawerk, as summarized by Von Mises, is revolutionary to most people, and sounds novel and even fantastic to them.

*"Liberty does not consist in doing what one pleases . . . liberty can only consist in being able to do what one ought to do."*

—MONTESQUIEU

*"The biggest public park is a poor substitute for the smallest private garden."*—W. ROEPKE

*"The man who first ruined the Roman people was the man who first gave them things for nothing."*—PLUTARCH

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Note And Appeal To Readers

This issue contains two long quotations. Consideration was given to rewriting the quoted material and printing it in regular-size type; but a rewrite would be less satisfactory than the original.

That brings us to a special request. *Please* read the material quoted from Böhm-Bawerk. It discusses the most controversial subject of this century — the validity of a return on capital.

That basic return is known as *originary interest*. The socialists-communists insist that originary interest is unjust — that it robs the employee. But they unfortunately misunderstand what originary interest really is. In fact, the correct proposition is exactly to the contrary of what socialists-communists affirm. The *only* way to be just is to retain originary interest in the system which society employs to distribute the proceeds of production to the respective people who have participated in what is produced.

Böhm-Bawerk makes the case exceptionally clear. He assumes a socialist situation — five men, *self-employed*, who divide the work required to make an engine which will sell for \$5,500. When these five men divide the proceeds “equally,” will each man properly receive \$1,100? That is what would be expected, but Böhm-Bawerk makes evident that that would involve conspicuous injustice.

Once Böhm-Bawerk’s material has been read and understood, it will not be possible for readers to look so critically or skeptically at originary interest as they may have done in the past. They will thereafter have before their minds the awareness that even in a socialist-communist society there will have to be such a division of the returns as will allow for originary interest, or else the distribution among the participants will involve an injustice.

It is not the *inclusion* but the *exclusion* of originary interest in the economic organization of society which involves an injustice.

See especially pages 247 to 251. Understanding of the contents of those pages is practically a prerequisite to understanding *justice* in society.

The subject is admittedly a difficult and complex one. Much more is involved than is presented here. But if the claims of the socialist-communist Exploitation Theory are not known to be illogical, illusory, and impractical, then it is not possible to think soundly about the greatest economic issue presently disturbing the whole world.

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## The Term, Originary Interest, Is Often Misunderstood

The use of the terms *originary interest* or *generic interest* to designate the "rewards" which the various kinds of ownership of capital provide (rewards, such as, rent on land, profits in business, interest on money) is not wholly fortunate. (For the meaning of originary or generic interest see July 1960 issue of FIRST PRINCIPLES.)

The term *interest*, in some circles, has come to mean a dubious reward, something *extra*, a *special* and *unearned* benefit which a landowner gets at the cost of alleged injury to a tenant on his land, a businessman gets at the cost of alleged injury to his customers or his employees, and a money lender gets at the cost of alleged injustice to a borrower. Such ideas are in error.

Further, it is mistakenly alleged that originary interest is not "in the nature of things" but is contrary to the nature of things. The allegation is made that arbitrary and unjust laws lie at the root of interest; that if laws did not protect the ownership of property (thereby allegedly favoring the rich at the expense of the poor) interest would disappear. In other words, the idea is that the phenomena of income derived from either land, capital or money is unearned, is undeserved, is exploitative, is unjust, and is something which should be extinguished, or at least limited.

\* \* \*

In the dictionary the term, interest, is indicated to be of Latin origin, and to mean "it concerns" or "it matters." More primitively, the word derives from *inter esse*, that is, *to be between* or *to be among*. In that original sense the term, interest, is suitable because it indicates *what is paid for what is inbetween*. And what is inbetween? Time, for one. But time is more or less meaningless for a human being except in the sense of a man not-having-now, or in the sense of being-obliged-to-wait, or in the sense of having-contracted-to-wait, or in the sense of being-prepared-to-wait-if-compensated-for-waiting. Time is meaningful in the sense of change and uncertainty.

"But," a skeptic may ask, "granted that interest of all kinds is associated with time (that is, with waiting), why should there be a reward for *waiting*?"

To that question the answer is that there is among human

beings a pervading tendency to evaluate what is in the future as being worth less than what is available now. A house available to you ten years hence is valued less highly by you than a house available to you now. The present you can enjoy; you are never sure that you will enjoy what is in the future. The uncertainty and changeableness of life and of the conditions of life underlie the practically universal discount in value that people apply to what is in the future. If life were neither uncertain nor changeable, men would not evaluate lower what is only available in the future.

\* \* \*

Basically, interest is not even a reward for waiting. The origin of interest derives instead from the finiteness of particular men; that they have a future before them which they cannot foresee; that they suffer from uncertainty about their own existence, and what their future needs will be. And so when they evaluate the future and the present comparatively, they "discount the future"; and naturally they discount anything and everything that is available only in that future; and the more remote the future, the more they discount it. The character of the *psychological response* of men to their finiteness and to the precariousness of the future for them — *that* only is the origin of originary interest, and must be the sole explanation.

The origin of interest does not lie in some factor pertaining to *supply*, such as, machine productivity or production labor; all such explanations look in the wrong direction; the origin of interest lies in a factor pertaining to *demand*, namely, in the lower evaluation put on anything and everything, by finite men, when they are dealing with something available only in the future.

The alternative general term to originary interest is originary *discount*.

The essence of the meaning of originary interest is best described by saying that it is the amount that has to be added to an equivalent future good to make it equal to a present good. If \$100 available one year from now is to be made equal to \$100 available now, then it is necessary to add \$5 to the future \$100, so that the real equation is \$100 now equals \$105 available a year hence. (That assumes that the prevailing discount of what is in the future amounts to 5% in that community. Circumstances may cause an evaluation which requires \$110 in the future in order to equal \$100

now; in other words, the rate of interest or discount varies by place, and also with time in a given place.) The illuminating fact is the following: \$100 available in the future is *discounted*, that is, is valued lower, and consequently to make a future sum equal to a present sum of the same amount something has to be added to what is available in the future in order to compensate for the discount attributable to human finiteness in relation to time. Originary interest or originary discount is not a reward to enrich anybody, but an addition to a discounted future, something added so that it really *equals* what is available in the present. Such discounting is the only ultimate explanation of rent, profit and interest — all taken in their originary sense.

\* \* \*

If men were gods, there would be no interest. But men are not gods, and therefore originary interest will continue to the end of the world, until the "last trump shall sound."

Any idea that originary interest can be removed by legislation, or by some lofty principle of morality, or that originary interest can permanently even be reduced by legislation or by some teaching of morality is self-deception. It *cannot* be done.

The phenomena of interest does not rest on statutory laws; nor the strength of the rich; nor the weakness of the poor. The phenomena of interest will not be ended by legislation, nor brotherly love, nor exalted morality.

To end interest — if that could be done — would be to initiate an injustice. When men understand originary interest, they do not wish to remove it.

The agitations to remove originary interest, or to reduce the percentage rate, rest on hapless fallacies and unfortunate misunderstandings.

Real understanding of interest, by anyone whose writings are extant, is as recent as the latest 75 years. Even today, understanding of interest among the public and among businessmen and economists is practically nonexistent.

\* \* \*

Originary interest is an offset, a compensatory amount necessary to the establishment of equivalence; it is not an extra; it is not a special reward; it is not an exploitation; it is not an injustice; it equates, for finite, short-lived changeable human beings the future with the present.

## The Dual Attack By Socialists-Communists On (1) Freedom and (2) Capitalism

Socialists-Communists make a dual attack.

1. In the first place, socialists-communists demand a society planned by themselves, rather than one planned by all men. They have in mind an *economic order* and a *political order*, which involves *compulsion* of others in order to accomplish what socialists-communists consider to be positive good. Anti-collectivists, in opposition to that, do not want a planned (that is, a *compulsory* society) but a free society, a society in which each man may pursue his own values (except, of course, he may not injure others by compulsion, dishonesty, fraud, theft of mate, etc.) In other words, one major subject on which socialism-communism commits itself is in regard to the *organization* of society, the "setting up" or "ordering" of communal life; in this connection socialists-communists are prepared to *compel* others to accept their pattern of what they believe to be "good."

2. In the second place, socialists-communists attack what they call an injustice, namely, the "earnings" of capital (that is, rent, profits, interest). Socialists-communists differ among themselves regarding how much *earned* income (wages or salaries) may vary among individuals, but in regard to what they call *unearned* income—the earnings on capital—they have a settled opinion, namely, that *all such income is unjust*. The income of the members of society should, they say, be equalized at least in regard to *none getting income from ownership of land, capital or money*. When a socialist or communist talks about the injustice of capitalism, then he is talking about the 5% return (more or less) which capital gets; or, more accurately, the "return" which capital gets varying from zero (or often a loss) to a rare, high annual percentage. On this question of a return on capital, that is, in regard to *originary interest*, the socialists-communists are primitively and vehemently vocal.

As will be shown later in this issue, socialists-communists nevertheless, on the basis of their own experience, will either retain originary interest or, if they have once doctrinairely abandoned it, they will reinstate it.

Eugen von Böhm-Bawerk wrote a large work in economics with the title, *Capital and Interest*. His first volume gives a history and critique of the popular, erroneous theories of interest; one by one Böhm-Bawerk rebuts ancient and modern explanations. His second volume describes the nature of capital, and explains the correct explanation of interest. His third volume presents a series of essays which are replies to criticisms against the second volume.

In Volume I, Böhm-Bawerk considers whether interest will, or can with justice, disappear in a socialist society. His argument is simple, interesting, and conclusive. Anybody can understand it.

### The Grand Economic Paradox

Should an employee — should everybody — earn all that he produces?

To that question the answer should be a definite *Yes*, or *No*.

An *employee* will at first say, "Yes; why should anyone else get any fraction of what I produce?"

An *employer* will be inclined to say, "Yes; but . . ." Then he will begin to hedge more and more; and he will probably end up saying lamely, "Of course, I must get a return on my investment." In other words, the employer considers his return on his investment (his originary interest) to be something that may have to come "out of labor." He may not be certain whether it does or not; in fact, he will seldom have tried to think through the problem. But he will insist on the necessity that he get his "return."

When an employer hears from noisy socialists-communists that originary interest does "come out of labor," and consequently that an employee cannot get the full value of what he produces, then the employer is more firmly disposed to settle on the answer, "No, an employee should *not* get *all* that he produces; a return on my investment *must* be deducted from my employee's production. I must have a fair return; and then the rest can go to my employees." And so, when driven to giving an unequivocal answer, most employers deny that an employee should get the full value, to the last penny, of what he produces.

Then many employees, although they answered *yes* in their first response to the question, after they hear an employer "think out loud," become uncertain, too; they recognize that the employer

is furnishing land, plant, tools, raw materials, and other requisites to being in business; in fairness, they in turn begin to qualify and they may end up saying, "Well, the man who furnishes the capital is entitled to a 'fair return.' The employer's capital enables me to be more productive. *But he should not profiteer.*"

Where are we now? An answer which should be a clear yes or no is hesitatingly or qualifyingly equivocated by both employee and employer.

John Public vacillates similarly; and moralists and theologians also emit an uncertain sound; they are reluctant to declare that an employee should get less pay than is equal to the value of what he produces; on the other hand, they realize that *property ownership becomes meaningless if it yields nothing*. When ownership of capital becomes genuinely valueless to an individual, he will no longer go to the trouble voluntarily to accumulate and preserve it.

\* \* \*

In all this confusion, uncertainty and equivocation, we shall in FIRST PRINCIPLES (following Böhm-Bawerk and the other neo-classicists in economics) unqualifiedly declare: AN EMPLOYEE IS ENTITLED TO THE FULL VALUE OF ALL THAT HE PRODUCES. THE EMPLOYER IS NOT ENTITLED TO "REDUCE" WAGES ON THE ALLEGED GROUND THAT HE MUST GET A RETURN ON HIS CAPITAL.

*That* statement may create alarm among capitalists and conservatives. They will interpret that answer as a surrender to socialism-communism. In a publication as FIRST PRINCIPLES, which is favorable to capitalism and unfavorable to socialism-communism, the answer may appear to be conspicuously inconsistent; but it is not.

Justice to the employee requires that he receive as his pay the *full value* of his production. Nevertheless, there will have to be, and consequently will continue to be, a return on capital.

But that, it will be alleged, is an irreconcilable and unacceptable *paradox*. Unless the paradox is thoroughly analyzed — and is removed by genuine understanding — modern men will be gravely confused and penalized for uncertainly swaying forward and backward in an endeavor to compromise between the employee getting full value and not getting full value.

The solution of the paradox depends on an understanding



that the *marginal utility of future goods is less than the marginal utility of equivalent present goods.*

What appears to be a paradox is not a paradox in fact.

## Charles P. \_\_\_\_\_ On Making A Profit On Labor

Charles P. \_\_\_\_\_ was an English emigrant to the United States. He never became a citizen. However, he became the head of a large United States manufacturing company in one of the "heavy industries."

He was a combination engineer-manager. He himself designed, or at least set the specifications, of most of the products which his company produced and sold. These products were in part manufactured (fabricated and assembled), and in part assembled only.

Charlie had soon discovered that he could get a bigger profit on items which he manufactured (that is, fabricated as well as assembled) than on items which had only assembly labor in them. On items consisting mostly of purchased parts and only a little assembly labor, the gross margin (from which selling and administrative expenses would not yet have been deducted) might be 15%, maybe 18% or 20%. But on a piece of machinery which his company fabricated, that is, made the castings or forgings, which it ground, tapped, reamed, drilled, heat treated, tested and assembled, in such cases, the gross margin could and would be 35% to 40%. (Note that the analysis pertains to *gross profit*, a term which is obviously not *net profit*; gross profit is here used in the customary accounting sense, that is, after all factory expenses but before all other costs and expenses have been taken into account.)

And so Charlie, sitting in a meeting one day, enunciated this principle: "We must get into our line more products which we fabricate ourselves, *because the only thing on which we make a profit is labor.*"

That was a most unfortunate dictum. No socialist or communist could have stated the accusation of socialism-communism against the justice of capitalism more perfectly than was implied by Charlie's remark. Here was a capitalist who admitted that profit is derived from giving labor less value than it produces. Every executive of the company sitting in that meeting accepted that dictum without protest; they did not seem to realize that the

right or the power of the company to *exploit* its employees had just been callously stated, as if it were a business necessity.

Charlie's company was situated in a large industrial city. The company paid the full going rate for wages in that community. If his company was nevertheless "making a profit *on labor*," that is, if his company was exploiting its employees, then obviously the other employers in the city, who paid no higher wages than Charlie did, were also exploiting their employees. If justice requires that the employees receive the full value of what they produce — and justice does require that — then in that city there was great injustice (on the basis of Charlie's admission).

But such conclusions are invalid, because Charlie was in error when he declared, "the only thing on which we make a profit is labor." He was perpetrating a gross paralogism, that is, a fallacy of which he did not realize he was guilty.

The fallacy Charlie committed is not at all unusual. It is practically universal.

### **Smith And Ricardo, Founders of Classical Economics, As The Originators Of The Fallacy That The Source Of All Value Is Labor**

Most of the conservative, capitalistic, free-market businessmen of the United States and throughout the world look at Adam Smith and David Ricardo as trustworthy spokesmen of sound economic theory. But these businessmen do not know that socialism-communism happily, smugly and soberly founds its theory concerning the exploitation of labor by capitalism on ideas expressed by Smith and Ricardo, the famous, reputed so-called anti-socialist economists.

Socialist economic theorists have, historically, looked with awe and respect on Smith and Ricardo. The economics of socialism is not by any means something completely contrary to the classical economics of Smith and Ricardo. It must be admitted that the claims of the socialists-communists that they have the blessing of Smith and Ricardo have merit.

But how can the capitalists claim Smith and Ricardo as their two great prophets, and how can the socialists claim them equally as prophets? To that the answer is that the writings of Smith and Ricardo are *not consistent*. The capitalists quote *some* of the ideas of Smith and Ricardo; the socialists quote *other* of the ideas of

Smith and Ricardo. In the large, the capitalists have a better claim to Smith and Ricardo as godfathers, but the merit of their claims is only one of degree.

From the foregoing fact an important conclusion can be deduced, namely, *in order to possess a satisfactory theory of what is a proper economic system something far better must be possessed than what Smith and Ricardo taught.* They are out-dated on the great economic issue of this age, namely, the justice of any return on capital, the justice of ordinary interest.

\* \* \*

In the one hundred years following Smith, the leading socialist thinkers appeared on the scene. They drew some conclusions, based on statements of Smith and Ricardo, which constituted a completely new system for society. Building on Smith and Ricardo, the socialists attacked the foundation of capitalism.

But hard on the heels of the socialists a new classical school developed, which is known as the Neoclassical school — Carl Menger, Eugen von Böhm-Bawerk, William Stanley Jevons, and later Ludwig von Mises. The neoclassical school rebuilt the foundations of economics.

In the process they devastated the arguments of the socialists-communists.

## Extracts From Böhm-Bawerk's "Historical Survey Of The Exploitation Theory"

One of the greatest classics in economics is Böhm-Bawerk's Chapter 12, in his HISTORY AND CRITIQUE OF INTEREST THEORIES, which chapter carries the title, *The Exploitation Theory*.

Several excerpts will be quoted from that chapter, the first of which has the subtitle, "Historical Survey of the Exploitation Theory."

### 1. General Characteristics of the Exploitation Theory

I now come to that notable [interest] theory the formulation of which may not be one of the pleasantest scientific events of the nineteenth century, but is certainly among its most portentous. It stood at the cradle of modern socialism and grew up with it. And it constitutes today (1884) the focal point about which attack and defense rally in the war in which the issue is the system under which human society shall be organized.

The theory has as yet no short and distinctive name. If I wanted to give it the name of a characteristic displayed by its principle followers, I could call it the *socialist* theory of interest. But if I am to be guided by a principle which I consider more appropriate, and make use of the theoretical

content of the doctrine itself as the source of its name, I could find no appellation more suitable, I think, than the *exploitation theory*. Compressed into a few sentences, the nature of the doctrine might...be described as follows.

All goods that have value are the product of human labor, and indeed, from the economist's point of view, the product of human labor *exclusively*. The workers however do not receive the entire product which they alone have produced. The capitalist exercises the control over the indispensable means of production which the institution of private property guarantees him, and he uses such control to secure for himself a part of the workers' product. His means of doing so is the wage contract which permits him to purchase the labor of the true producers, who are forced by hunger to accept the contract. The price the capitalist pays them is a fraction of what is produced by them, and the rest of the product falls into the lap of the capitalist at the cost of no exertion to himself. *Interest therefore consists in a portion of the product of the labor of others, acquired by exploiting the situation which places the worker under coercion.*

## 2. Origin of the Exploitation Theory

The genesis of that doctrine had been foreshadowed long before and had in fact become inevitable because of the peculiar turn taken by the economic doctrine of value after Smith and even more after Ricardo. It was generally taught and believed that the value of all goods, or at least of the very great majority of economic goods, is measured by the amount of labor they embody, and that this labor is the origin and the source of the value of goods. Such being the case, it was inevitable that sooner or later the question should arise, why the worker did not receive the entire value to which his work had given rise.

And as soon as that question had been raised, it was impossible to find any answer except one which could conform to the spirit of that same theory of value. That answer was that, after the fashion of the drones, one group of society, namely the capitalists, appropriates unto itself part of the value of the product produced solely by the other party in society, namely the workers.

To be sure, the originators of the labor theory of value did not as yet give this answer... But the answer was nevertheless inherent in their doctrine and followed as its necessary logical consequence. It needed but a suitable motivating incident and a disciple addicted to the lure of the syllogism, to guarantee that it rise to the surface sooner or later. So Smith and Ricardo may be considered the unwilling godfathers of the exploitation theory. And they are regarded as such, even by the followers of the theory. They, and they almost alone, are spoken of by even the most dogmatic of socialists with the sort of respect that is due the discoverers of the "true" law of value. . . .

... the birth of the exploitation theory as an integrated doctrine... was preceded by... [another] devolpment, . . . the victorious spreading of capitalist mass production which,

by creating and exposing a yawning gulf between capital and labor, at the same time moved the question of interest derived without labor into the forefront of the great social problems.

Under the influence of such forces as these our own era seems to have been ready ever since the third decade of the nineteenth century for the systematic development of the exploitation theory. . . . The earliest *theorists* to develop the exploitation theory in...detail were William Thompson in England and Sismondi in France.

... Thompson ... starts with the theoretical premise that labor is the source of all value and arrives at the practical conclusion that the producer is entitled to the entire proceeds of what he has produced. He makes the statement that the worker, despite this claim to the full produce of his labor, actually is limited to a wage that is barely sufficient for subsistence, while the additional value that can be derived from an equal amount of labor by the use of machines and other capital is taken by the capitalists who have amassed it and advanced it to the workers. Land rent and interest therefore represent deductions from the full produce of labor, to which the worker is entitled.

\* \* \*

The...work of Sismondi which exercised so much influence, insofar as our subject is concerned, bears the title, *Nouveaux principes d'économie Politique*. In this work Sismondi's thesis sets out from premises which he shares with Adam Smith. He accepts the latter's principle that work is the sole source of all wealth, and agrees with it warmly. He is displeased because the three types of income, namely rents, profits and wages are frequently attributed to three different sources, namely land, capital and labor. In actual fact, says Sismondi, all income arises only from labor, and those three categories are merely so many different ways of participating in the fruits of human labor. For the worker, by whose activity all goods are produced, has "in our stage of civilization" not been able to retain control of the necessary means of production. In the first place, arable land is usually the private property of another, and the owner demands a part of the fruits of the worker's labor, in return for supplying the cooperation of the "productive force" termed land. Such part constitutes land rent. In the second place, the productive worker ordinarily does not possess a sufficient supply of provisions on which to live during the time he is performing his labor. Nor does he own the raw materials and the frequently costly instruments and machines necessary for production. The rich, who own all these things, thus acquire a certain control of the labor of the poor. Without doing any of the work themselves, they take in advance the best part of the fruits of that labor, to compensate themselves for the advantages which they put at the disposal of the poor... This "best part" is interest. . . .

And although the laborer's daily efforts produce far more than his daily needs, there is little left over for him, after he has shared with the landowner and the capitalist, than his bare subsistence, which he receives in the form of wages. The worker needs his subsistence much more than the entrepreneur needs the worker's labor. He needs his

subsistence to be able to live, whereas the entrepreneur needs his labor only to make a profit. And so the bargain almost always turns out to the disadvantage of the worker . . .

Anyone who has followed Sismondi's exposition thus far, and has also read the sentence which states the "rich devour the product of the labor of the others" will necessarily expect Sismondi to conclude by declaring interest an unjust and extortionate gain that is to be condemned. But that is not the conclusion Sismondi draws. Suddenly shifting ground, he manages to conjure up a few obscure and ambiguous clichés in favor of interest, which finally stands before us robed in righteousness. First he says of the landowner that he earned a *right* to land rent by the original labor of making the land arable, or even by settlement of virgin territory. Similarly he endows the owner of capital with a right to interest based on the "original labor" to which the capital owes its existence. These two types of income have one characteristic in common, in that they constitute income derived by virtue of ownership, and they may therefore be contrasted with income which is derived by virtue of the performance of labor. And yet Sismondi manages to establish their good repute by demonstrating that they, too, owe their origin to labor, being different only in that their honorable origin dates back to an earlier era. For the worker, through new labors, acquires every year a new claim to income, while property owners in an earlier period of time and through original labors acquired a permanent claim which makes each year's work more advantageous. "Everyone," he concludes, "receives his share of the national income only in proportion to what he or his representatives contribute or have contributed to the creation of that income." . . . Sismondi does not offer any answer to the questions whether and how this last statement can be reconciled with his earlier ones, according to which interest is something taken in advance out of the fruits of other persons' labor.

However, others very soon and very decidedly drew the conclusions which Sismondi himself did not dare to draw from his own theory. He is the connecting link between Smith and Ricardo on the one side, and the subsequent doctrines of socialism and communism on the other. . . .

### 3. The Socialists

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The author of the *Contradictions économiques*, P. J. Proudhon . . . accepts as established the principle that labor creates all value. Hence the worker has a natural claim to ownership of his entire product. By his wage contract he foregoes that claim in favor of the owner of the capital and in return for a wage which is *smaller* than the product which he foregoes. Herein he is cheated. For he is not aware of his natural right, nor of the magnitude of his concession, nor yet of the significance of the contract which the property owner makes with him. In this transaction the owner takes advantage of error and surprise, not to say deceit and sharp practice. . . .

\* \* \*

The German Rodbertus is fully the peer of Proudhon in the purity of his presentation, by far his superior in the profundity of his thinking and his prudent insight, but admit-

tedly far inferior to the passionate Frenchman in the vividness of his language. For the historian of economic theories he is the most important of the personalities that deserve mention at this point. For a long time his scientific significance went unrecognized and, strangely enough, because of the very fact that his work is so predominantly scientific. Because he did not make his appeal as others did directly to the populace, because he restricted himself primarily to scientific investigation of the social question, because he was moderate and restrained in his practical proposals as they affected the most immediate interests of the great masses, his reputation lagged for a long time behind that of other far lesser men who took over his intellectual wares second hand, and in their own fashion made them palatable for the interested multitude. . . .

... Ferdinand Lassalle [was] the most eloquent, but as to content the least original of the socialist leaders. I mention him here only because his brilliant eloquence enabled him to exercise great influence on the spreading of the theory of exploitation. ... his contribution to its theoretical development is just about nil. . . .

While Lassalle is an agitator exclusively, Karl Marx is pre-eminently a theorist, and indeed, after Rodbertus, the most distinguished theorist of socialism. Although his doctrine coincides in many respects with the pioneering research of Rodbertus, he displayed ... originality and ... keen logic in developing his doctrine into a distinctive whole with which it will likewise be our duty shortly to become thoroughly acquainted.

So much for extracts from Böhm-Bawerk's historical summary of the exploitation theory.

We shall turn next to Böhm-Bawerk's classic analysis of the basic proposition of Rodbertus, Marx, and other socialists-communists, namely, that originary interest is derived from the exploitation of the employee. Böhm-Bawerk shows to the contrary that, originary interest is derived from factors associated with *time* and not with *labor*, that is, that *originary interest is not and cannot be exploitation*.

## Extracts From Bohm-Bawerk's Critique Of The Exploitation Theory

### A. GENERAL OUTLINE OF THIS CRITIQUE

... to approach the task of a critique of the exploitation theory . . . I...[select] from the great multiplicity of individual statements of the theory two which I consider the best and the most complete, and to subject these individually to criticism, [namely, those of] ... Rodbertus and Marx. They are the only ones which offer a reasonably profound and coherent foundation. Rodbertus's is, in my opinion, the best presentation of the theory. Marx's however is the most widely recognized, the one that is, so to speak, the official

pronouncement of modern socialism. By subjecting both of them to a detailed examination, I am looking at the exploitation theory, I think, "with its best foot forward." . . .

## B. RODBERTUS

### 1. Detailed Presentation of Rodbertus's Doctrine

The point of origin for Rodbertus's theory of interest is the principle "introduced into the science of economics by Smith and more firmly corroborated by the Ricardo school" to the effect that "all goods, economically considered, are only the product of labor and cost nothing except labor." Rodbertus elucidates this principle, which is habitually expressed in the form "only labor is productive" by stating it as follows. *Firstly*, only those goods belong to the class that may be termed economic goods, which have cost labor, while all other goods, no matter how necessary and useful they may be to man, are *natural* goods which have nothing to do with economics. *Secondly*, all economic goods are *solely* a product of labor, and from the economist's point of view are not to be conceived of as produced by nature or any other power, but only by labor. Any other view belongs in the field of the physical sciences rather than economics. *Thirdly*, all goods are, economically considered, the product of only that labor which performed the material operations which were necessary to their production. But such labor includes not only that labor which produces the good directly, but also such labor as creates the instrument which serves in the production of the good concerned. Grain, for instance, is the product not only of the labor that drove the plow, but also of that which built that plow, etc.

The manual workers who create the entire good have a natural and just claim, at least "according to the idea of pure justice," to acquire title to their entire product. But there are two important reservations. In the first place, the system of division of labor under which a great many cooperate to produce a single product, makes it a technical impossibility that each worker receive his product in kind. Therefore in place of the claim to the whole *product* must be substituted the claim to the entire *value* of the product.

Furthermore there must be some provision made out of the sum of all products, for a share for all those who render useful service to their fellow men without participating directly in the making of the product, as for instance, clergymen, physicians, judges, naturalists and also, in Rodbertus's opinion, the entrepreneurs who "know how to employ a large number of workers productively by means of a capital." But such labor, which is only "indirectly economic," will have to urge its claim to be compensated, not out of the "original distribution of goods," in which only producers share, but out of a "secondary derivative distribution of goods." Hence the claim which, under the idea of pure justice, can be advanced by the manual workers, is to be construed as a claim to the *whole value of the product of their labor in the original distribution*, undiminished by reason of the secondary claims to compensation by other useful members of society.

Rodbertus finds that under the present organization of



society this natural claim is not realized. For workers today receive only part of the value of their product at the original distribution in the form of wages, while the rest falls to the share of the owners of land and of capital in the form of surplus proceeds (*Rente*). Rodbertus defines surplus proceeds as "all income that is received without work, purely on the basis of ownership of property." It includes two kinds of income, *interest on land* and *interest on capital goods*.

Rodbertus now asks, "Since all income is the product of labor, why do some members of society draw income, and in fact original income, though they have not stirred a finger to produce it?" With those words Rodbertus has framed the general theoretical problem of interest. His answer to the problem is as follows:

Surplus proceeds owe their existence to the combined effect of two facts, the one economic and the other legalistic. *The economic reason* lies in the fact that since the introduction of the division of labor, the workers' labor produces more than they need for their subsistence, and for the continued performance of such labor. As a result, others, too, can live off that labor. *The legal reason* lies in the existence of private ownership of land and of capital goods. Since the workers are excluded by this institution of private property from control of the conditions indispensable to production, they cannot produce at all except as employees of the proprietors and under the terms of a previously concluded agreement. And the latter, in return for making the conditions of production available, impose upon the workers the obligation to cede a portion of the product of their labor as surplus proceeds. . . .

According to this argument all surplus proceeds are the fruit of *exploitation*, or as Rodbertus occasionally puts it still more caustically, a *theft* of the product of other men's labor. . . .

The amount of excess proceeds increases with the productivity of labor. For under the system of free competition the worker receives generally, and in the long run, just the amount necessary for subsistence, that is to say, a definite concrete quantity of the product. Now the greater the productivity of labor, the smaller is the percentage of the total value of the product which that concrete quantity of the product represents. And the greater is the percentage of the product and of the value, which is left over as the portion of the owners, that is to say, their interest.

... in spite of the severe theoretical condemnation which represents Rodbertus's verdict in judging the predatory character of interest, he does not desire the abolition of either private ownership of capital nor of the income from it. Rather does he ascribe to private ownership, both of land and of capital "an educative power" which we cannot forego, "a sort of domestic power which we should be able to replace only if we had for that purpose a completely different national system of education. But for that we do not as yet have even the necessary conditions." In the meantime he thinks of private title to land and to capital goods as a "species of public office which entails national economic functions —

functions which consist in guiding the economic labor and the economic resources of the nation as best befits the national needs." From this favoring point of view interest can be looked upon as a sort of salary which those "public officials" receive for the exercise of their functions.

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## 2. Deficiencies of Rodbertus's System

That brings me to my critique of Rodbertus's doctrinal system. Let me say at once and without mincing matters that I consider the interest theory which is a part of it to be completely erroneous. I am convinced that it suffers from a series of grave theoretical defects. . . .

### a. The Erroneous Statement That The

#### Value Of Goods Depends On Labor Content

The first stumbling block which my critical appraisal encounters is the cornerstone on which he erects his structure. He lays down the principle that all goods, economically considered, are only the products of labor.

First of all, what does he mean by "economically considered"? Rodbertus clears that up by an antithesis and contrasts the point of view of economic science to the point of view of the physical sciences. He expressly concedes that goods are physically the product, not only of labor but also of the forces of nature. If nevertheless goods are supposed from the economist's point of view to be only the product of labor, he can mean only one thing. He must mean that the cooperation of natural forces in the process of production is a factor to which we may be completely indifferent when we study human economy. On one occasion Rodbertus expresses this point very strongly when he says, "All other goods (other than those which have cost labor), no matter how necessary or useful they may be to man, are natural goods, with which *economics has no concern*." "Whatever preliminary results nature has achieved may be a cause for human gratitude, for man has been spared just that much work. *But economics takes them into account only insofar as labor has complemented the work of nature.*"

That is just downright wrong. Even purely natural goods, whenever they are rare in comparison with the need for them, are the concern of economics. Or does a nugget of pure gold that falls as a meteorite on a landowner's property, or a silver mine which he happens to discover on his land mean nothing to the economist? Will the owner allow the gold or silver which he has received as a gift from nature to lie disregarded, or will he give it away, or squander it, merely for the reason that nature has presented it to him without any exertion on his part? Or will he not take care of it just as carefully, protect it from the greed of others, prudently dispose of it on the market, in short, husband it with the same economy as he would in the case of gold and silver which he had acquired through the labor of his hands? And is it really true that economics concerns itself with those goods which have cost labor, only to the extent to which *labor* has complemented the work of nature? If that were so, the economic behavior of men would treat a barrel of the choicest Rhine wine as the absolute equivalent of one of those local country wines which, though well tended, is by nature a mediocre vintage. For approximately the same

amount of human labor has been expended on each. The fact that nevertheless the Rhine wine often has an economic value 10 times as great, is an eloquent refutation which life offers of Rodbertus's theory.

Negations of that kind are so obvious that Rodbertus could really have been expected to intrench his first and most important fundamental principle behind very carefully prepared defenses against them. But such expectations are unfulfilled. Rodbertus has marshalled a few items intended to make his thesis convincing. But they consist partly of some not overly persuasive references to authorities, and some just as unconvincing argumentation which does not touch the point at issue, but evades it.

The former category includes his oft-repeated invoking of Smith and Ricardo as authorities. . . . We shall have occasion a little later to establish the interesting fact that Smith and Ricardo *merely allege* the axiomatic truth of the principle we are discussing *without furnishing any proof of it whatsoever*. And furthermore, both of them have themselves failed to adhere consistently to that principle, as has been very nicely demonstrated by Knies. Now it... [should be] *obvious that in a scientific discussion even authorities [must] furnish proof, not by the weight of their names, but by the cogency of the reasons that they advance*. But since in this case the names are not represented by any reasons at all, nor even by a consistently maintained statement, the conclusion is inescapable that... Rodbertus's [by] invoking of authorities... [accomplishes] no actual strengthening of his position; and furthermore that that position is entirely unsupported except for such arguments as he himself is able to advance for his thesis.

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**b1. Bohm-Bawerk's Famous Unrivalled Argument Using The \$5,500 Engine As An Illustration; Phase (1) The Argument With One Man On The Job**

Rodbertus's next thesis is that by the laws of nature and according to the "idea of pure justice" the entire product, having been produced by the worker alone, must belong to the worker, or in lieu of it, its full value without deduction.

I am fully in accord with this thesis, too, since under the terms of the limiting presupposition which I stipulated before, there can be no question of its correctness and its fairness.

But I do think that Rodbertus and all the other socialists have a false conception of the realization of this truly just principle. Misled by that misconception they desire the creation of a condition which is not in accordance with the principle, but directly opposed to it. I consider it remarkable that the numerous attempts that have been made hitherto to refute the exploitation theory have touched on this decisive point only superficially at best, but never presented it in its true light. I shall therefore take the liberty of requesting my readers to devote some measure of attention to the following development of the point. This difficult subject certainly requires it.

*The error that I censure I shall first name and then elucidate. The completely just proposition that the worker is to receive the entire value of his pro-*

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*duct can reasonably be interpreted to mean either that he is to receive the full PRESENT value of his product NOW or that he is to get the entire FUTURE value in the FUTURE. But Rodbertus and the socialists interpret it to mean that the worker is to receive the entire FUTURE value of his product NOW. At the same time they act as if that were entirely self-evident and the only possible interpretation of that proposition.*

Let us illustrate the matter by a concrete example. Let us imagine that the production of a good, for instance a steam engine, costs five years' labor, and that the completed machine commands a price of \$5,500. Let us further ignore for the moment that in actual practice the labor is distributed among many workers, and imagine that a single workman produces the machine by five years' continuous labor. Now let us ask what wage is due him in the sense of the proposition that the worker is to receive his whole product, or the full value of his product. There cannot be a moment's doubt that the answer is the whole steam engine or \$5,500. But *when?* On that score, too, there can be no slightest doubt. Obviously at the expiration of five years. For by the laws of nature he cannot receive the steam engine before it is in existence, cannot gain possession of a good valued at \$5,500 and created by himself, before he has created it. In that case he will have received his compensation according to the formula, "the whole future product, or its whole future value at a future time."

It often happens that the worker cannot or will not wait until his product has been fully completed. Our worker wishes, for instance, after the expiration of one year to receive a corresponding partial compensation. The question arises, as to how that is to be measured in accordance with the aforementioned principle. I think this, too, can be settled without a moment's hesitation. The worker will get justice if he gets all that he has labored to produce up to this point. If, for instance, he has up to this time produced a pile of unfinished ore, or of iron, or of steel material, then he will be justly treated if he receives the pile of ore, of iron, or of steel, or receives the full exchange value which this pile of material has, and of course has *now*. I do not think any socialist could find fault with that decision.

How large will that value be, in relation to the price of the finished machine? Here is the point at which a superficial thinker can easily go wrong. The worker has up to this time performed a fifth of the technical work which the production of the entire machine demands. Accordingly a superficial consideration of the problem might tempt us to answer, the present product will possess an exchange value of one-fifth of that of the whole product, that is to say, \$1,100. The worker is to receive a year's wage of \$1,100.

That is wrong. One thousand one hundred dollars is one-fifth of the price of a completed, present steam engine. But what the worker has produced up to this time is not one-fifth of a machine that is already finished, but only one-fifth of a machine which will not be finished for another four years. And those are two different things. Not different by a sophistical splitting of verbal hairs, but actually different

as to the thing itself. The former fifth has a value different from that of the latter fifth, just as surely as a complete present machine has a different value in terms of present valuation from that of a machine that will not be available for another four years. And it will be so, just as it is true in general that present goods have a value different from that of future goods.

That present goods have a higher value, in the esteem of that present time in which the economic events take place, than future goods of the same kind and quality, belongs to the most widely known and most important economic facts. . . . The crudest empirical tests of everyday life establish it beyond any question of a doubt. If you ask 1,000 persons to choose between a gift of \$1,000 today and \$1,000 50 years from today all 1,000 of them will prefer to have it today. Or ask another 1,000 persons who are in need of a car, and who would be willing to pay \$2,000 for a good one, how much they would give today for an equally good car to be delivered in 10 or 15 years. All of them would offer a far smaller sum, if indeed they offered anything at all, thus demonstrating that people, when acting economically, universally regard present goods as more valuable than identical future goods. Accordingly our worker at the end of a year's work on the steam engine that will be finished in another four years has not yet earned the entire value of one-fifth of a completed engine. He has earned some smaller amount. Smaller by how much? I cannot at this point explain that without a lot of awkward anticipation. Let the remark suffice here that the amount of that difference bears an ascertained relationship to the rate of interest prevailing in the locality as well as to the remoteness of the time at which the whole product is scheduled to be completed. If I assume a prevailing interest rate of 5% then the product of the first year's labor will, at the end of the first year, be worth about \$1,000. And so, if the principle is valid that the worker is entitled to the full product of his labor, or to the entire value thereof, then the wage for the first year of labor will amount to \$1,000.

If anyone has the impression, in spite of the line of reasoning laid down above, that this is too little, I offer the following for consideration. No one will question the statement that the worker is not being underpaid if at the end of five years he receives the whole steam engine or its whole price of \$5,500. Let us for the sake of comparison also compute the price of the anticipated payment of wages in terms of its price at the end of the fifth year. Since the \$1,000 that he receives at the end of the first year can be deposited for another four years at interest he can thus earn interest at 5% for four years. That is to say, he can receive an additional \$200 (ignoring the compounding of interest) for the possibility of using his money that way is open to the worker when he has received his wage. Obviously then, \$1,000 paid at the end of the first year is the equivalent of \$1,200 paid at the end of the fifth year. So if the worker gets \$1,000 at the end of a year for one-fifth of the technical work, he is clearly being compensated by a standard which is not less favorable than if he had received \$5,500 at the expiration of five years.

But how do Rodbertus and the socialists envision the principle that the worker is entitled to receive the entire

value of his product? *They demand that the entire value which the product is going to have when completed shall be used for payment of wages, but not at the conclusion of the whole process of production, but made available in installments during the course of the work.* Let us weigh carefully what that means. That means, in the case of our steam engine, that the entire \$5,500 which the engine will be worth at the end of five years, is received by the worker at the end of  $2\frac{1}{2}$  years, which is the result attained by averaging the installments received over five years. I must confess I find it absolutely impossible to justify this demand by that premise. How can it be according to the laws of nature and in keeping with the idea of pure justice, for someone to receive at the end of  $2\frac{1}{2}$  years a whole which he will not have created until the end of five years? This is so little "in accord with the laws of nature" that it is, quite on the contrary, just naturally impracticable. It is not feasible even if we free the worker from all the bonds of his much maligned wage contract, and put him into the most favorable conceivable position of an entrepreneur entirely "on his own." As a worker and entrepreneur he will of course get the whole \$5,500, but not before they are produced, that is to say, not before the end of five years. And how is a thing to be brought to pass, in the name of the idea of pure justice, through the instrumentality of the wage contract, which the nature of things denies to the entrepreneur himself?

*What the socialists want is, in plain English, for the workers to get under the wage contract, MORE than their work produces, more than they could get if they were entrepreneurs in business for themselves, and more than they bring in to the entrepreneur with whom they have made the wage contract.* What they have created, and what they are justly entitled to is \$5,500 at the end of five years. But the \$5,500 at the end of  $2\frac{1}{2}$  years, which is what is being claimed for them, is more than that; in fact if the interest rate is 5%, it is equivalent to about \$6,200 at the end of five years. And this state of relative valuations is not, mind you, the result of social institutions of debatable merit which have created interest and established a rate of 5%. It is a direct result of the fact that we humans live out our lives in a temporal world, that our Today with its needs and cares comes before our Tomorrow, and that our Day-After-Tomorrow may perhaps not be assured us at all. Not only the "profit grasping capitalist," but every worker as well, indeed every human being makes this difference between present value and future value. How the worker would complain of being cheated, if in place of \$10 out of his week's wages which are due today he were offered \$10 to be paid a year from today! And is something that is not a matter of indifference to the worker supposed to be such to the entrepreneur? Is he to pay \$5,500 at the end of  $2\frac{1}{2}$  years for \$5,500 which he is to receive, in the shape of a finished steam engine, at the end of five? That is neither just nor natural! The thing that is just and natural—I am glad to concede it again—is that the worker should receive the whole \$5,500 at the end of five years. If he cannot or will not wait five years, he shall still receive the entire value of what he produces. But of course it must be the *present* value of his *present* product. This value however will necessarily be smaller than the future

value of the product which his labor produces, *because in the economic world the law obtains that the present value of future goods is less than that of present goods. It is a law which owes its existence to no social or governmental institution, but directly to human nature and to the nature of things.*

If there is any excuse for... [elaboration] anywhere, it might be at this point where it is a question of the... [refutation] of a doctrine as pregnant with... [dangerous consequences] as is the socialist exploitation theory. ...at the risk of seeming tedious to my readers, I shall submit a second concrete case which will, I hope, afford me an opportunity of proving the socialists' error even more convincingly.

**b2. Bohm-Bawerk's Famous Unrivalled Argument Using the \$5,500 Engine As An Illustration; Phase (2), With Five Men On The Job**

In our first example I ignored the fact that division of labor is an economic actuality. Now I shall change the conditions of the problem in this respect so as to approach the realities of economic life more closely. Let us assume that five different workers participate in the labor of producing a machine, and that each of them contributes one year's work. One worker, perhaps, is a miner who procures the necessary ore, the second prepares the iron from it, the third transforms the iron into steel, the fourth constructs the necessary steel parts, the fifth finally assembles these and, in general, does the finishing. Since each of these successive workers, by the nature of his work, cannot begin his work until the one before him has completed his preparatory stage of the work, the five years' work of our laborers cannot be carried out simultaneously, but only in succession. The completion of the machine, just as in our first example, will likewise take five years. The value of the machine we shall again assume to be \$5,500. Now, in conformity with the principle that the worker is to receive the full price of what he produces, what can each of the five who share the labor claim for what he accomplishes?

Let us first solve the problem for a case in which there is no introduction of an outside entrepreneur, and in which therefore the claims to compensation, or the method of dividing the article produced need to be adjusted only among the five workers. In such a case two things are certain.

The *first* of these is that a distribution of the product itself cannot take place *until the expiration of five years*, because before that time there is nothing there to divide. For if there were any desire, at the end of the second year let us say, to distribute to the individuals as compensation the ore and the iron that had been produced in the first two years, then the raw materials would be lacking for the succeeding stages. On the contrary, it is clear that the intermediary product that is achieved each year must be excluded from any early distribution and retained for the production process until its conclusion.

The *second* thing that is certain is that there will be a total of \$5,500 to be distributed among the five workers. But in what proportions?

Certainly not, as one might easily suppose at a first—and superficial—glance, in equal fifths! For that would mean



a distribution favoring the worker whose labor is performed in later stages, over those whose work was done early. The worker who puts the finishing touches on the machine would receive \$1,100 for his year's work immediately after its conclusion. The one who prepared the individual parts for assembling into the complete machine would receive the same amount, but would have to wait a whole year after he had completed his work to collect his compensation for it. And then there is the extreme case of the worker who mined the ore, and who would not receive his wage until four years after he had completed his work. Since a delay of that sort could not possibly be a matter of indifference to the persons concerned, everyone would want to perform the final labor, which does not suffer any postponement of compensation, and no one would want to assume the work of the preparatory stages. In order to find anyone to assume those jobs, the workers in the late stages would be compelled to consent to an arrangement by which a larger portion of the ultimate exchange value of the product would be accorded to their co-workers in the preparatory stages, to compensate them for the delay. The amount of the difference would depend partly on the length of the postponement, and partly on the degree of difference in the valuation of present and future goods which prevails within our small society, as determined by the economic and cultural conditions which exist there. If the degree of that difference is, for instance, 5% per year, then the shares of the five workers would be graduated as shown below.

The first worker, whose wage is not paid to him until four years after the completion of his year's labor, receives	\$1,200
The second, who waits three years	1,150
The third, who waits two years	1,100
The fourth, who waits one year	1,050
The last, who receives his wage immediately upon completion of his labor	1,000
Total	\$5,500

It would be inconceivable that each of the workers should receive an equal share of \$1,100 except under the hypothesis that the difference in time is a matter of indifference to them. It would be conceivable only if they all considered themselves equally well paid at \$1,100, no matter whether they received that sum three or four years later, or immediately after finishing their labors. I hardly need to observe that such a hypothesis never holds, and never can hold. But in the absence of the introduction of a third party it is in any case *completely impossible for each of them to receive \$1,100 immediately after completion of his labors.*

It is probably worth while in passing to call special attention to one circumstance. I do not think that anyone could find the distribution plan that I have recorded an unjust one. And I am especially convinced that, since the workers share their own product only with each other, there can be no contention that there has been an injustice done by a capitalist entrepreneur. And yet the worker who completed the next-to-last fifth does not receive a full fifth of the ultimate price of the product. He gets only \$1,050, and the last worker caps the climax by receiving only \$1,000!

Now let us make the further assumption, with which reality is ordinarily in agreement, that the workers cannot or will not wait for their wages until the process of producing the machine has been completed. That leads to their entering into an agreement with an entrepreneur whereby they will receive their wage immediately upon completion of their labor, in return for which he is to become the owner of the final product. Now let us make the still further assumption that this entrepreneur is an entirely just and unselfish man who would be thoroughly incapable of making use of any possible distress to which the workers might be a prey, in order to depress by extortionate measures their claims to wages. Let us ask what the conditions would be of a wage contract drawn up and signed under such circumstances.

The answer is fairly easy to find. Obviously the workers are being treated with complete justice if the entrepreneur offers them as a wage the same as they would have received as their distributive shares, had they been engaged in independent production. This principle gives us a reliable standard for one worker, to begin with, namely, the last of the five. The latter would have received \$1,000 immediately after performing his work. So the entrepreneur, to be completely fair, must offer him the same \$1,000. But the rest of our table of shares does not give us any direct standard. For since the point of time at which compensation is made is now different from the one that would have applied in the case of their own distribution of shares, the amounts set up for the latter would no longer be directly applicable. However, we have another firm criterion. For since all five workers have contributed the same amount of service toward the genesis of the product, they are in justice entitled to equal wages. And since each one is paid immediately after he has completed his labors, the wages will be equal sums. Justice is served if each worker receives \$1,000 at the end of his year's labor.

If anyone should think that that is too little, I refer him to the following easy example in arithmetic. It will prove that the workers now receive exactly the same amount as they would have received through a distribution among themselves—and that amount was shown to be indubitably just. Worker No. 5 receives \$1,000 from the distribution, immediately after the end of the year's work, and in the case of the wage contract he receives the same amount at the same time. Worker No. 4 receives \$1,050 through the distribution, one year after his work is completed; in the case of the wage contract he receives \$1,000 immediately after his work is completed. Now if he puts that out at interest for a year, he achieves exactly the same position that he would have in the case of the distribution, for he then has \$1,050 one year after completing his work. Worker No. 3 receives by the distribution \$1,100 two years after his work ends; by the wage contract \$1,000 immediately which, put out at interest, amounts to the same \$1,100 at the same time. In the same way the \$1,000 which the first and second workers receive under the wage contract, with the addition of interest are exactly equal to the \$1,200 and the \$1,150 which, under the distribution, would have been received after four

and three years respectively. And if each of the individual wage sums is the equivalent of the corresponding distributional share, then the aggregate of the wage sums must be equivalent of the aggregate of all the distributional shares. Hence the total of \$5,000 which the entrepreneur pays immediately upon performance of the labor to the workers is the exact equivalent of the \$5,500 which, in the other case, could have been distributed among the workers at the end of the fifth year.

Any higher wage, such as a yearly wage of \$1,100 would be conceivable only under one of two alternatives. Either something to which the workers are not indifferent, namely the difference in time, would have to be a matter of complete indifference to the entrepreneur, or the entrepreneur would have to have the desire to make a gift to the workers of the difference between \$1,100 in present funds and \$1,100 in future funds. Neither the one alternative nor the other is to be expected of the private entrepreneur, at least not as a rule. Nor could one make it a matter of the slightest reproach, and least of all would it justify a charge of injustice, [or] exploitation . . . There is only one person of whom the workers could expect such behavior as a regular thing, and that is the *state*. For the state is, on the one hand, an entity that exists in perpetuity, and is not therefore compelled to take such strict account of the temporal difference in the giving and receiving of goods. And the state, whose ultimate purpose is the welfare of all its members, can, on the other hand, afford to give instead of to bargain. And so it would concededly be thinkable for the state—but *only* the state in its capacity of giant entrepreneur in the production field—to offer the workers a wage representing the entire future product of their future production and to give it to them *now*, that is to say, immediately after the performance of their labor. Whether the state shall or shall not do so, and thereby afford a practical solution of the social problem in terms of socialist doctrine, is a question of expediency, which it cannot be my purpose to discuss here. But one thing I should like to repeat here and with all possible emphasis, and that is this. If the socialist state pays out now to the workers, as wages, the entire future exchange value of their product, then that is not a *fulfillment but a violation* of the fundamental principle that the worker is entitled to receive as his wage the value of what he produces. And it is a deviation dictated by social and political considerations, rather than the restoration, as the socialists allege, of a situation which of itself is natural or which accords with the idea of pure justice, but has been upset through the avidity of the capitalists for exploitation. On the contrary, it is an artificial interference intended to render possible what in the natural course of things is an impossibility, and to make it possible by means of a veiled and perpetual gift by a generous communal entity known as the state, a gift granted to its more penurious members.

And now a short practical application. It is easily perceived that the stage of distribution which I last described in our example, is the one at which we have actually arrived in our market economy. In this system too, the full value of the product of labor is not distributed as wages, but only

a lesser sum, though at an earlier point in time. But the worker suffers no unjust curtailment in his claim to the full amount of what he produces, provided one condition is fulfilled, and that condition provides as follows. The total sum of wages distributed in installments must not fall short of the ultimate price of the final product by a greater amount than is necessary to bridge the gap representing the prevailing difference in the valuation of present and future goods. In other words, the total wages must not be exceeded by the price of the final product to a greater degree than is represented by the prevailing interest rate. The workers in that case receive the full value of their product at a valuation which duly reflects the point in time at which they receive their wage. Only to the extent that the total wage lags behind the ultimate exchange value of the product by a margin in excess of the prevailing interest can that lag, under some circumstances, indicate genuine exploitation of the workers.

Let us return to Rodbertus. The second decisive error with which I charged him in the immediately preceding pages was his interpretation of the statement that the worker is entitled to receive the entire value of his product. I conceded the correctness of the statement but not of his unjustified and illogical interpretation, to the effect that the worker is entitled to receive *now* the entire exchange value which his completed product *will some day have*.

#### c. Ricardo's Exception Which Rodbertus Ignored, And Which Destroys The Theses Of Both Ricardo And Rodbertus

If we institute search to discover what led Rodbertus into this error, we find that the source of it was still another error, and the *third* important one which I hereby charge he made in his exploitation theory. For he proceeds on the assumption that the exchange value of goods is determined exclusively by the quantity of labor which their production has cost. If that were a correct assumption, then the intermediary product, which in our example represents one year's labor, would indeed at that stage already be invested with a full fifth of the value which the completed product, with its five years of labor behind it, will one day possess. And in that case there would be justice in the claim that the worker is already entitled to a full fifth of that value as his wage.

But in the form in which Rodbertus presents it, his assumption is unquestionably wrong. Now, if challenged to prove this, I am not even under the necessity of discrediting Ricardo's famous law of value, that labor is the source and the measure of all value. I merely need to call attention to the existence of a highly important exception to that law. It is an exception which Ricardo himself conscientiously registered, and which he discussed in detail in a special chapter. But Rodbertus, strange to say, takes no note of it whatever. *That exception concerns the fact that, if two goods have been produced at the cost of equal amounts of labor, then a higher exchange value will attach to the one which requires for its completion either a longer period of time, or the prior performance of a greater amount of preliminary work.* Ricardo accords notice to that fact in strange fashion. In Section IV of the first chapter of his *Principles* he makes

the following statement: "The principle that the quantity of labor expended on the production of goods determines their relative value, is subject to considerable modification by reason of the use of machines and of other fixed and durable capital." In Section V he adds, "also by reason of the unequal duration of capital and the unequal rapidity with which it is returned to its owner." Sometimes the production of goods requires the use of fixed capital of great magnitude or of long duration; sometimes production is of such a nature that a long turnover period is required for the entrepreneur to recover his liquid capital. Goods so produced have a higher exchange value than goods to which these considerations apply in lesser degree or not at all, despite the fact that the latter may have cost the same amount of labor as the former. And the degree of difference in such exchange value is the amount of interest charged by the capitalist.

Even the most partisan defenders of his labor theory of value could hardly harbor any doubt that there really is such an exception to it as is here observed by Ricardo. They may be equally certain that under certain circumstances the factor of temporal remoteness may have even greater influence on the price of goods than the factor of magnitude of labor costs. I remind my readers, as examples, of the price of a wine which has been seasoned for decades, or of a 100-year-old tree in a timber forest.

But there is another very special point in connection with this exception. For it does not require any unusual keenness of perception to notice that the exception really contains the essence of ordinary interest. For the margin in exchange value which is acquired by those goods that require for their production an *advanced expenditure of capital*, is the very thing that sticks to the fingers of the entrepreneur capitalist in the guise of interest, when the time comes for the distribution of the yield of the product. If that difference in value did not exist, then ordinary interest would not exist either. The former makes possible the latter, encompasses it, is identical with it. There is nothing easier than to illustrate this, if indeed any one demands proof of such a patently obvious fact. Let us assume that three consumers' goods require for their production one year's labor each, but that they differ from each other in the length of the period for which this labor must be advanced. Let the first require that the year's labor be performed only one year prior to completion, the second ten years previously, the third twenty years previously. Under these circumstances the exchange value of the first good will and must be sufficient to cover the wage for one year of labor and in addition the interest for one year on the amount of the labor "advanced." It is perfectly obvious that the same exchange value is not sufficient to meet the wage of one year's labor and in addition either the ten years' interest or the twenty years' interest on an "advance" of the same amount of labor. The payment of such interest can be met only when and because the exchange value of the second and third consumers' good is correspondingly higher than that of the first, even though all three have equal labor costs. And the difference

in exchange value is clearly the source from which the ten years' and twenty years' interest can and does flow.

And so that exception [by Ricardo himself] to the labor theory of value has no lesser significance than that it is identical with the... [very origin] of originary interest. Whoever wants to explain... originary interest must explain Ricardo's exception. Without an explanation of the exception, there is no explanation of the interest problem. If a treatise makes it a point to deal with originary interest, and yet ignores this exception, not to say denies its existence, then that must be characterized as a blunder so gross that its equal cannot be imagined. For Rodbertus to ignore that exception is nothing short of an utter disregard of the main topic of the subject he was supposed to explain.

Nor can it be urged as an excuse for his blunder, that Rodbertus had not intended to establish a rule that was valid for real life, but merely to set up a hypothesis of which he availed himself, in order to conduct his abstract investigation with greater ease and accuracy. He does, to be sure, on occasion advance, in the guise of a mere presupposition, his dictum that the value of every good is determined by its labor costs. However there is no dearth of passages in which Rodbertus reveals his conviction that his law of value also has validity in real economic life.

... in addition it must be urged against Rodbertus that it is not permissible to assume by way of presupposition anything one wishes! Even in the case of a merely hypothetical presupposition, it is permissible to eliminate from consideration only such factual elements as are irrelevant to the question under examination. But what can be said of a scientific inquiry into interest which begins by presupposing that one of the main instances of interest does not exist? What of an explanation in which the best part of that which is to be explained is conjured away "by hypothesis"!

\* \* \*

## The Error In The Thinking Of Charles P\_\_\_\_\_

On pages 233 and following the idea of the late Charles P\_\_\_\_\_, president of a big business, was quoted, to wit, that "the only thing on which this company makes a profit is labor." Fortunately, there was not a word of truth in that.

Charlie had noted, as was reported earlier, that his company could make only a very small margin of profit on machinery produced and sold which did not have very much "company labor" in it. If the company was required to expend much labor to produce a machine, it could make a good profit margin; if it was not required to expend much labor to produce a machine, the profit margin rate was small. The profit margin rate apparently went up and down in proportion as much or little labor was required to produce a machine. Charlie therefore concluded that the profit his company made was based on the amount of labor

expended; in other words, his company made its profit "off of labor"; in still other words, the employees of his company did not receive the full payment equal to the value of what they produced, but only part of it. The company got a "cut" out of what the employees produced.

That is a statement by a corporation president about a situation concerning which socialists-communists complain bitterly, viz., that the employees are *exploited* in proportion as a company makes a net profit.

What was Charlie's error? He mistook *labor* for *investment in manufacturing equipment*. He did not make his profit "off" of his employees, but off of his equipment. This was an error easy enough to make. In Charlie's shops there were rows on rows of lathes, drill presses, grinders; there were several big boring bars; etc. The whole factory was a mass of machinery. For every machine there was a man, or more—Charlie's "labor." But for every employee there was also a huge investment in equipment. It depends whether you wish to look at the men or at the equipment. Charlie looked at the men; he should have looked at the equipment.

Under no circumstances, however, should one look at the *productivity* of that equipment as the source of the profit (that is, originary interest). To do that is to fall into an equally great error as to look at labor as the source of the profit. (This fallacy based on *productivity* will have to be discussed at some other time. Nearly all capitalists perpetrate this fallacy.)

Further, under no circumstances should one look at the *depreciation* of the machines as the source of the profit. Depreciation of machines—their wearing out—is a legitimate cost of production, and to confuse depreciation with profit is also a gross fallacy.

Then how can the equipment in Charlie's plant be considered to be the source of originary interest? The answer is related to *time*. It is not the depreciation of the equipment that explains the originary interest, but the *investment in such equipment which has not yet been depreciated*. That remaining investment will have to be worn out during *future* years. It is the utilization of that investment which is postponed into the future, just as the pay of the first workman on the \$5,500 engine, described by Böhm-

Bawerk, was postponed five years — and for which he *in justice* demanded an allowance, that is, a greater pay than his fellow workmen would get. Similarly, the not-yet-depreciated value in long-lasting production equipment is a *future value* as much as the unfinished \$5,500 engine in Böhm-Bawerk's illustration.

Consider a lathe in Charlie's shop good for 10 years. Assume that it cost \$10,000. For simplicity of calculation, the depreciation may be taken at \$1,000 a year. (That depreciation does not have the semblance of profit, as it is merely to provide for replacement of the lathe when it is worn out.) But it is the *undepreciated investment*, \$9,000 at the end of the first year, \$8,000 at the end of the second year, and so on, those amounts which are not yet "recovered" in the depreciation reserve until 9 years, and 8 years, etc., which is the base for the originary profit, and which is the "discount of the future" as was previously explained. The owners of Charlie's business must be rewarded for their investment-which-is-not-to-be-used-until-later. To justify their having \$9,000, etc., invested and unavailable to them now and not "used up" until later, requires that they get back as much more than \$9,000, etc., as the rate of the prevailing discount for what is in the future.

If they did not receive that reward for the delay in their using up of their equipment, they would shift their investment to something else. If there were no allowance for the time factor — for the "discount of time" as previously explained — then violence would be done to an ineradicable psychological factor in the character of finite men.

Charlie had many other assets on his balance sheet which were "usable" only in the future, and whose discounted future value would need an augmentation (in the form of interest) to make that future value equal to the present value, such assets as land, buildings, raw material, in-process inventory, accounts receivable. In greater or lesser degree all these investments in Charlie's business had to carry their originary interest rate for a longer or a shorter time. All these items contributed to explain Charlie's profit, rather than as he himself thought, his "exploitation" of his labor force.

This subject requires more elaborate explanation than the foregoing, but the "logic" of the time factor in originary interest should now be somewhat apparent.



## Reprint Of Böhm-Bawerk's Whole Chapter On The Exploitation Theory

Böhm-Bawerk's analysis of The Exploitation Theory is 80 pages long, in large format, with closely set type, and has eight pages of Notes in small type. It is a small book in itself.

This chapter has just been reprinted in a paperback by Libertarian Press, South Holland, Illinois (\$1.50). This special edition has an excellent Preface by Dr. Hans F. Sennholz, dean of the economics department of Grove City College, Grove City, Pennsylvania.

The subjects covered in this chapter are grouped under three main headings: (A) Historical Survey of the Exploitation Theory; (B) Critique of the Exploitation Theory (that is, a critique of Rodbertus and Marx); and (C) The Marxian Doctrine as Interpreted by His Successors. Only a small part of all that has been quoted in the foregoing.

As an intellectual performance, nothing in the earlier history of economic thought equals what Böhm-Bawerk produced in his *Capital and Interest*, and his chapter on The Exploitation Theory is one of the finest in that great economic work.

Nobody can really afford to neglect to read the reprint. Every personnel manager, economist, labor union official, politician, businessman, philosopher, theologian or ethical teacher — to name only some — ought to read and study Böhm-Bawerk's whole analysis of the exploitation theory of the socialists-communists. And having read it, they will be thoroughly alerted against its indefensible foundation.

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Solomon Versus Marx On The Question Of Value

In economics, *value* is a peculiarly significant term. Laymen are often unaware how important its meaning is in economics.

Factors which have been alleged to be the causes of *value* fall into either of two groups. One of these groups is in the area of *supply*; the other is in the area of *demand*.

For example, if *value* depends upon *labor* or *material* that was put into the making of something, then a factor of *supply* created the value.

Contrarily, if *value* depends upon the needs and wishes of a buyer, then a factor of *demand* created the value.

The first thought of many is that a *supply* factor determines value. Businessmen often believe that; they tell you that costs determine prices. As price is a way of expressing value, businessmen (when they say "costs determine prices") are really saying that "costs determine value."

Socialists-communists are in the same category as such businessmen. Socialists-communists declare that "socially necessary labor" required to make something is the sole determinant of value. Here again, a factor pertaining to supply is set forth as the cause of value. We shall quote Karl Marx on this subject in some detail.

If a man believes that a supply or cost factor determines value,

his insight is inadequate; he is a sound economic thinker only when he *ascribes value solely to demand*.

### Solomon As An Economist

One of the wisdom books of the ancient Jews is Ecclesiastes. Authorship is ascribed to Solomon, king of Israel, and successor to his famous father, King David. In Ecclesiastes Solomon writes as a good economist, because he ascribes value solely to demand. Solomon wrote (Ecclesiastes 3: 1a, 2b, 3b, 5a, 6, 7a):

For everything there is a season, . . . a time to plant and a time to pluck up that which is planted; . . . a time to break down, and a time to build up; . . . a time to cast away stones, and a time to gather stones together; . . . a time to seek, and a time to lose, a time to keep, and a time to cast away; a time to rend, and a time to sew; . . .

The foregoing can be restated as follows: There is no intrinsic value in anything; what was put into it does not determine value; only the use to which someone wishes to put something determines value; what has value today may be worthless tomorrow, depending on the changing needs, wishes and demands of people.

What was planted with great labor today may be not only valueless but so harmful that it must be plucked up tomorrow. Did the thing planted change? Was a factor in the supply or cost altered? Not at all; the *demand* changed, and that is why that which was planted laboriously is "plucked up." Similarly, in the case of building or breaking down; casting away stones, or gathering them; seeking or losing; rending or sewing.

In other words, *demand* dominates the economic world. Naturally, problems of supply and cost remain important, but they are dragged along behind demand like a wagon is dragged behind a horse. The *key to value* is *demand*.

A man obsessed with the idea of thrift may tell you that thrift is a virtue which requires that *nothing* should be destroyed. The latter proposition is false. A factory may be useful — the foundation may be good; the walls may be solid; the roof may not leak; windows and doors may be in good condition; but *depending on the purpose of men*, that is, depending on a factor in demand, it may

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be wise to wreck a factory and build another; or sell the land for a highway; or build a shopping center instead.

In the estimate of her husband, a woman can be fickle, unpredictable and wasteful in her purchase of clothing for herself, furniture for the house, and equipment for the utility room. What matters for her? She wants what she wants. Those are her *values*. He might expect her judgment to be governed by stark utility, but in the case of most women it is not — (something for which men should be thankful, because women would then look drab and houses would be unaesthetic as jails). There is, to be sure, the problem of adjusting supply to demand, cost with price; but supply and cost are only the *second* actors in the drama; the *first* actor is demand.

A man is as variable in his "demand" as is a woman. If the man manages the yard, he will be found changing the landscaping from time to time; transplanting; taking something out; putting something in. What was done a few years ago he no longer wants. Gone is the labor that went into it; the time has come to "break down." It is because his values have changed.

In this life, men being finite, circumstances ever changing and needs varying, no economic good has intrinsic value, as if something existed with value in itself. *Value is not intrinsic in the thing nor objective to the person; it is instead extrinsic to the thing and subjective in the person.* It is always that way; it is never otherwise, and therefore Solomon was right when he said you should throw away, rend and break down, as well as gather, sew and build.

### Marx An Economist

Karl Marx was not a good economist, and he lacked Solomon's penetration of judgment. Marx's position was that value is intrinsic in the thing and objective to the person, that is, value comes from the thing itself, not from a buyer.

Marx declared that a thing has value because something has been put into it. That "something" he said was the "socially necessary labor." An automobile has value because of the labor that went into assembly; into fabrication of the parts; into purchase of raw materials (for which prior labor was necessary); into machinery and buildings (for which other prior labor was necessary).

Marx, when he hitched value to labor, reversed the proper relationship. He hitched the cart before the horse. He said: some-

thing has value because it has labor in it; what he should have said was that labor was put into something because the end product was wanted and would have value.

It is not difficult to see that Marx was confused, or deliberately wrong, about "labor value." One man may require two days of work to do something; another man may easily do it in a day. Is the value determined by the inefficiency of the first man, or the efficiency of the second? Marx's proposition almost says that the harder you make it for yourself to do something, the greater the value of the product you produce; that is nonsense, and Marx realized he could not leave the matter rest there.

To meet that obvious objection Marx developed his concept of "socially necessary labor." This is a vague and undefinable concept, which is presumably an average, and the result of removing from the calculation the exceptionally efficient and inefficient. That makes Marx's proposition sound more plausible, but really all that he has done is create an indefiniteness that tends to obscure mental clarity on the subject.

When the writer looks out of his window he can see construction work on a repaving job. Forty years ago the street was graded by means of horses and small scrapers, and cement was hand-mixed on the job. That old paving is being torn out — as Solomon said, there is a time for destroying — and a pavement twice as wide is to take its place. There is not a horse employed on the job, and not one-twentieth of the men employed formerly. The excavation is being done by a new excavator which does the work of fifty men.

What then is "socially necessary labor?" The operator of the machine, when he clambered out of its cabin one Saturday, declared that this machine was one of the first exemplars in existence, and that no other was yet in operation in the Middle West. When new equipment becomes available, the efficiency of "labor" changes. And so "socially necessary labor" is not a fixed measuring stick; it *cannot* be. Any idea of measuring value by a variable and varying cost is a self-contradiction. But Marx wrote ponderously to that effect.

We shall quote a critique of the Marxian theory of value, taken from opening paragraphs in Chapter I of Böhm-Bawerk's essay, *Zum Abschluss des Marxschen Systems* (which title might be translated (freely) into English as, *The Unresolved Contradic-*

tion in the Completed Marxian System). (We are using the Alice Macdonald translation):

The pillars of the system of Marx are his conception of value and his law of value. Without them, as Marx repeatedly asserts, all scientific knowledge of economic facts would be impossible. . . . I [shall] recapitulate briefly the most essential points of his argument.

The field of research which Marx undertakes to explore in order "to come upon the track of value" he limits from the beginning to *commodities*, by which, according to him, we are not to understand all economic goods, but only those *products of labor* which are made for the market. He begins with "Analysis of a Commodity." A commodity is, on one side, a useful thing, which by its properties satisfies human wants of some kind; and on the other, it forms the material medium of exchange value. He then passes to an analysis of this latter.

"Exchange value presents itself in the first instance as the quantitative relation, the proportion, in which values in use of one kind are exchanged for values in use of another kind, a relation which constantly changes with time and place."

Exchange value, therefore, appears to be something accidental. And yet there must be in this changing relation something that is stable and unchanging, and this Marx undertakes to bring to light. He does it in his well-known dialectical manner.

"Let us take two commodities, wheat and iron, for example. Whatever may be their relative rate of exchange it may always be represented by an equation in which a given quantity of wheat is equal to a given quantity of iron: for example, 8 bushels of wheat = 1 cwt. of iron. What does this equation tell us? It tells us that there exists a common factor of the same magnitude in two different things, in 8 bushels of wheat and in a cwt. of iron. The two things are therefore equal to a third which is in itself neither the one nor the other. Each of the two, so far as it is an exchange value, must therefore be reducible to that third.

"This common factor . . . cannot be a geometrical, physical, chemical or other natural property of the commodities. Their physical properties come into consideration for the most part only in so far as they make the commodities useful, and so make them values in use. But, on the other hand, the exchange relation of commodities is obviously determined without reference to their value in use. Within this relation one value in use is worth just as much as any other, if only it is present in proper proportion.

"If then we abstract [the essence] from the value in use of commodities, there remains to them only one common property, that of being products of labor. But even as products of labor they have already, by the very process of abstraction, undergone a change under our hands. For if we abstract from

the value in use of a commodity, we, at the same time, abstract from the material constituents and forms which give it a value in use. It is no longer a table, or a house, or yarn, or any other useful thing. All its physical qualities have disappeared. Nor is it any longer the product of the labor of the carpenter, or the mason, or the spinner, or of any other particular productive industry. With the useful character of the labor products there disappears the useful character of the labors embodied in them, and there vanish also the different concrete forms of these labors. They are no longer distinguished from each other, but are all reduced to identical human labor — abstract human labor.

"Let us examine now the residuum. There is nothing but this ghostly objectivity, the mere cellular tissue of undistinguishable human labor, that is, of the output of human labor without regard to the form of the output. All that these things have now to show for themselves is that human labor has been expended in their production — that human labor has been stored up in them; and as crystals of this common social substance they are — values."

With this, then, we have the conception of value discovered and determined. It is in dialectical form not identical with exchange value, but it stands, as I would now make plain, in the most intimate and inseparable relation to it. It is a kind of logical distillation from it. It is, to speak in Marx's own words, "the common element that manifests itself in the exchange relation, or exchange value, of commodities"; or again conversely, "the exchange value is the only form in which the value of commodities can manifest itself or be expressed."

After establishing the conception of value Marx proceeds to describe its measure and its amount. As labor is the substance of value so the amount of the value of all goods is measured by the quantity of labor contained in them, which is, in its turn, measured by its duration — but not by that particular duration, or working time, which the individual who made the commodity has happened to need, but the working time that is socially necessary. Marx defines this last as the "working time required to produce a value in use under the normal conditions of production, and with the degree of skill and intensity of labor prevalent in a given society."

"It is only the quantity of socially necessary labor, or the working time socially necessary for the production of a value in use, which determines the amount of the value. The single commodity is here to be regarded as an average specimen of its class. Commodities, therefore, in which equal quantities of labor are embodied, or which can be produced in the same working time, have the same value. The value of one commodity is related to the value of any other commodity as the working time necessary for the production of the one is to that necessary for the production of the other. As values, all commodities are only specific quantities of crystallized working time."

... It is true that in isolated cases according to momentary fluctuations of supply and demand prices occur which are over or under the values. But these

"constant oscillations of market prices . . . compensate and cancel each other, and reduce themselves to the average price as their inner law."

In the long run

"the socially necessary working time always asserts itself by main force, like an over-ruling natural law, in the accidental and ever fluctuating exchange relations."

Marx declares this law to be the "eternal law of the exchange of commodities," and "the rational element," and "the natural law of equilibrium."

Such is Marx's idea on the sole source of value, namely, labor. But the idea is a fallacy, involving at least confusion, if not being disingenuous. Being, as it is, the foundation of Marx's "economics," it has resulted in all of Marxian economics being incorrect and damaging. His excuse might be that the idea of the source of value was not original with him, but was borrowed from Adam Smith and David Ricardo.

(Businessmen can offer a similar excuse, namely, that they too borrowed their ideas on value from some of the statements of Smith and Ricardo, namely, that value is based on factors of supply. True, businessmen affirm that the factors of supply that create value are broader than labor, namely, there are the factors of capital and land as well as labor, but the fact remains that they stay in the same basic category with Smith, Ricardo, and Marx, to wit, that value depends on a factor or factors of supply.)

### **The Neoclassicists, Or The School Of Subjective Economics**

On the tombstones of Smith and Ricardo there should have been a warning slogan to the effect, "Here lies Adam Smith (or David Ricardo); the road in economics outlined by him who lies here does not continue, but has a quick DEAD END." The epoch-making work of these men reached its apex in these men themselves. For further advance a new and better understanding of value was needed — an understanding that value is founded on demand and not on supply. That is why the ideas of the successors of Smith and Ricardo (those who left unchanged the Smithian and Ricardian foundations regarding value) were really intellectually sterile — especially John Stuart Mill (1806-1873), and Alfred Marshall (1842-1924).

Only that part of the Smithian and Ricardian systems should



be retained which is compatible with the school of thought, known as Subjective Economics, or Neoclassicist — the school of Jevons (1835-1882), Walras (1834-1910), Wicksell (1851-1926), but especially Menger (1840-1921), Böhm-Bawerk (1851-1914) and Mises.

Menger made the most influential and impressive transition in the thinking on the origin of value, from something *objective in a thing* to something *subjective in a person*. Menger reasoned as did Solomon in 1,000 B.C., that *demand is antecedent to value*; that value is variable and varying; that it may disappear with changing circumstances; that men give value to something and that the value is not intrinsic in a thing.

When value was discovered to be subjective, the natural thing to do was to name that type of economics, Subjective Economics. That type of economics differs radically from Smith's or Ricardo's. When Marx built on Smith and Ricardo in regard to value, and when businessmen do the same, he (and they) are simply rebuilding faultily on a base as outmoded today as the idea that the world is flat.

Other ideas of Smith and Ricardo were not equally wrong or useless. Ricardo's illuminating Law of Association or Cooperation is unaffected by his basic error in regard to *value*. Similarly, much of the great work of Smith stands. But to modernize — to validate — basic thinking in economics, it is necessary to turn to Subjective Economics.

#### **Subjective Economics, And The Correct Explanation Of The Origin Of Originary Interest**

It was only the later Neoclassicists, Böhm-Bawerk and Mises (basing their work on that reconstruction of the explanation of value which makes value depend on something subjective), who could possibly find the correct explanation for *originary interest*. (For the meaning of originary interest see pages 217-223.)

Böhm-Bawerk was not the first to note that something available in the future has a lesser value than the same thing available now, but he was the first fully to realize either its general significance in life or its decisive significance in regard to originary interest. It was because he clearly saw *the effect of time on evaluation* that he could come to clarity that all explanations of interest which fixed their attention on a supply factor — as human labor or productivity

of a machine — must be defective. If interest is legitimate, which it is, a basic factor pertaining to demand would have to be the explanation of interest; that factor is remoteness in time; the more remote in time that some good is, the lesser its value.

If a man loans another \$1,000 today to be repaid a year hence, then in order to make the *future* sum of \$1,000 (which is universally discounted in value by men) equal to the *present* sum of \$1,000 an amount of \$50 (equal to the assumed prevailing discount estimated at 5%) must be added.

This explanation of interest, which is the only one that is logically correct and the only one that cannot be rebutted whereas all others can, is based on *value differentials between the present and the future*.

And so, originary interest is a special problem in *value*, namely, present value versus a discounted future value, which latter must be made equivalent to the former by the payment of originary interest.

## Overvaluation Of Human Foresight In The Marxian Dictum - "All Value Is Founded On Labor"

To allege that "all value is founded on labor" involves an arrogant estimate of human judgment.

1. It assumes that labor is never unintelligently applied. Suppose you decide to put a sewer in your block in the east side of a street. But you hit a stone ledge, and must blast through rock; your cost is 2,000 hours of labor. You could have altered your plan and put the sewer in the west side of the street where there was no stone ledge. Suppose the people in the next block put the sewer in the west side of the street and it costs them only 500 hours of labor — one-fourth as much. Is your sewer worth four times as much as theirs, because it required four times as much labor? Of course not.

2. It assumes that men do not change their minds. A house was begun some distance up the street. The basement and floor were constructed. Then the work ceased. The owner decided to change jobs, and now he does not wish to live there. Apparently nobody wishes to build presently on that location and foundation. Has *value* there been enhanced by the labor applied? Indeed not. There will be enhanced value there only when somebody "wants"

that lot *and* foundation. Until that happens, the foundation will make the lot less valuable than a bare lot.

3. It assumes that life is static. One of the leading artistic designers in this country, in describing his method, expressed himself as follows: "You do a few things and see how they look; you add; change; subtract, and keep on doing that; finally you have what you want." How many "false" moves were made? Hundreds, maybe thousands. The costs of innovations are unpredictable and variable. Millions of hours of design labor end with no value attached to the end-result. "Socially necessary labor" — the term used by the socialists — implies standard merchandise; no changes; no improvements; merchandising stagnation.

4. A man's life is a record of much wasted labor. The University of Illinois some years ago sent a dozen special black walnuts which the writer planted. That was labor cost number one. The nuts all germinated and grew. After one growing season, I transplanted them, at the cost of onerous labor, because the root system of a black walnut tree grows amazingly deep in one season, something about which I was ignorant; ignorance is always expensive. I should have planted the walnuts in the first instance where I wanted the trees to be. I could have saved the transplanting labor. Did my bad judgment or ignorance, which caused more work to be required, add to the value? None. Then a neighbor complained about one of the trees. Who wishes to argue with a woman? I sawed that tree down. More labor! But that has surely not added value, because the tree is gone. Black walnut trees are not, I have discovered, handsome trees. The branches hang down in a droopy fashion. I continue to trim off branches. More labor! Are the trees more valuable? Maybe. But my spouse continues to urge for aesthetic reasons that *all* the black walnut trees *should be removed!* She has the ability to suggest it in various and sundry manners. I am desperate. What value do those trees have now? Sometimes, I sadly conclude, they are worth less than nothing; they have a dis-utility, to wit, the future sweating labor to cut them down, drag them to the back yard, let them dry, and then burn them.

The idea that those black walnut trees have a value based on the labor that has gone into them! The idea infuriates me, because I know it is not true.

It is not necessary to be an economist to realize that value does NOT depend on a cost factor of any kind, labor included.

Value *ultimately* depends solely on *demand*.

*Costs* are not causes of value, but are really consequences of value. Only as much *cost* is incurred as demand will tolerate. My "demand" regarding walnut trees has changed, and so the labor in them is lost.

Nor should one "reason in a circle" and say, "But demand depends on the price, and price is determined by costs." Space is not available to rebutt that fallacy here. (See Böhm-Bawerk's rebuttal in his *Capital and Interest*.)

## How Men Avoid Overpricing Land

Suppose your father owns 160 acres of excellent farm land, and that you are the sole heir. You come home to the farm for an October vacation and on a beautiful morning you stand in the farm yard and look over the rolling fields spread out before you in all their rural charm. And this is what you think:

1. Some day this farm will be mine, as it is my father's now, and was my grandfather's earlier. Some day it will belong to my children, and my grandchildren; maybe for thousands of years.

2. This farm will yield an annual cash rent of \$25 an acre. On 160 acres that is \$4,000 a year, available year in and year out. If I and my descendants keep the farm for 2,000 years, we will collect \$8,000,000 in rent, because 2,000 years times \$4,000 a year amounts to \$8,000,000.

Your wife comes out to stand beside you, and you address her: "Dorothy, this farm is worth millions; if our descendants keep it 2,000 years, the income (rent), without even compounding it, will amount to \$8,000,000. If we compound the rent, this farm is worth hundreds of millions. Is it not wonderful?"

But Dorothy is unimpressed. She takes a quick side-look at you to see if you are normal. She knows that you cannot be drunk. She too stares over the fields, and then there is a note of sarcasm in her voice when she answers: "Eight million? Sell it as soon as you can, and buy me that beautiful \$12,000 mink coat at Charles' Fashion Shop, that I never figured I could afford to own. If this farm is worth \$8,000,000, you can afford to buy me that coat right now. Eight million? Why you can buy this farm for \$80,000."

You become uncomfortably aware that you have made an error when you concluded something is properly priced by multiplying (1) the annual production or income by (2) the length of time that it will be available.

In fact, by the process of multiplying income by the length of time for which it is expected to accrue, results are obtained that have no meaning whatever as far as the *value* of such property is concerned.

\* \* \*

If you wife's words sting you; if you have a capability for generalization (as Newton had); and if you exercise that capability, then you will reach an important conclusion, which will thereafter be revolutionary for all your economic thinking, to wit: *the VALUE of property does NOT primarily depend on its PRODUCTIVITY*. Real estate agents may dispute that; bankers may manifest indignation when they hear it; businessmen may feel amused; your own "common sense" may tell you that the proposition is absurd.

The fact remains, however, that the 160-acre farm which you will inherit is "worth" \$8,000,000 or more, if production really determines value. The farm, however, is not worth \$8,000,000, but (as your wife said) only \$80,000, only one-hundreth as much.

It is the exceptions which test — and maybe discredit — a rule. The rule we all are disposed to accept is that the value of something depends on its yield, or its productivity. If that is a *rule*, or a principle, and if you apply it to a farm you will inherit, and if the rule then gives you an absurd answer, and permits your wife to have a malicious note of sarcasm in her voice, why dismiss the matter without further thought, and why not examine critically the rule you are applying, a rule which you have always accepted? If there is an exception — and you were just caught in a bad one by your own wife — then the "exception proves the rule" — that is, it *tests* the rule and may invalidate it. You just valued your future inheritance by its productivity. But you must yourself know that the answer is wrong. Here is how you reasoned:

*Major Premise:* The productivity of something determines its value.

*Minor Premise:* This farm has a productivity which has a value of \$4,000 a year.

You can now come to either of two conclusions, or anything between which you are arbitrarily prepared to accept.

- Conclusion (1): This farm has a value of \$4,000; or  
 Conclusion (2): This farm has a value of \$8,000,000 in  
 2,000 years (and a value of infinity in  
 eternity).

Neither conclusion is worth the paper on which it is written. You cannot buy that 160-acre farm yielding \$4,000 a year, for \$4,000, and nobody will pay you \$8,000,000.

It happens that a farm yielding \$4,000 may be saleable (presently) for \$80,000, that is, the price will be 20 times its net annual productivity. *Why 20 times?* At another time it may sell for 25 times its net annual productivity; or 15 times. But any figure of 15 to 25 (or a wider range) is obviously *obtained by some principle independent of productivity.*

Several months ago in FIRST PRINCIPLES there was an analysis to discover whether and how an inventor could profit from a labor-saving, cost-reducing and/or production-increasing invention. But the inventor was not able to keep all of it for himself, nor for long. *Values* apparently created by inventors and producers, or values associated with ownership, seem to slip away, as quicksilver out of a man's hand, except that there is eventually a modest amount left, something equivalent from 3% to 7% a year, something maybe averaging 5%.

We conclude then: (1) labor does not create value (see the August issue); (2) nature (land) does not create value (see the foregoing); (3) capital (an invention, machinery, a tool) does not create value (see the March, April, June and July issues). To believe that what goes into something gives it value is self-deception, a paralogism.

\* \* \*

Having eliminated (1) labor and (2) productivity (of land or capital) from the explanation for the value of property, *then what does cause and explain originary interest*, the generic term used, in economic theory, to designate interest on money, profits in business, or rent on land?

The answer is: *the finiteness of the individual man in time, and his consequent practice of "discounting the future"* — a logical procedure for him.

What was mistaken in your calculation when you estimated that the farm you would inherit was worth \$8,000,000? This: you did not *discount* — estimate as having lower value — what was to

become available only in the more or less distant future. The crops being harvested and marketed this October might have for your father a value of \$4,000. Suppose at the end of the month he gave you the farm. At the end of the next twelve months you would have obtained the \$4,000 return. What is the *present* value of that *future* \$4,000 one year away? The answer is \$3,809. Why the discount of \$191 (\$4,000 minus \$3,809)? Because you and others normally value lower what is available in the future compared with what is available in the present. (The *prevailing* discount we have arbitrarily assumed to be 5%; we obtained the \$3,809 by dividing \$4,000 by 1.05. That is the same as saying that \$3,809 at 5% interest will be worth \$4,000 one year hence.) On this tendency to discount what is available in the future see pages 217-224 in the July issue of FIRST PRINCIPLES.

There will be a further discount of the value of the crop available only after *two* years; it can be computed by dividing \$3,809 by 1.05, which yields \$3,628. (This method of dividing in a chain of divisions by 1.05 simply "compounds" the discount at 5% annually.)

If on October 31 of this year your father gives you the farm, then what is the *present* value of the *future* income for the next 150 years? An analysis of what happens in 150 years will make clear that from then on the \$4,000 yield annually from the farm means practically nothing — *presently*. The calculations are shown below:

**TABLE I**  
**Present Value of Future Annual Farm Income of**  
**\$4,000 a Year, Ownership Beginning October 31, 1960,**  
**and the First Crop Being Available October, 1961**

Crop Available Oct. 31	Time Elapsed (Years)	Present Value	Crop Available Oct. 31	Time Elapsed (Years)	Present Value	Crop Available Oct. 31	Time Elapsed (Years)	Present Value
1961	1	\$ 3,809	1971	11	\$ 2,338	1981	21	\$ 1,435
1962	2	3,628	1972	12	2,227	1982	22	1,367
1963	3	3,455	1973	13	2,121	1983	23	1,302
1964	4	3,290	1974	14	2,020	1984	24	1,240
1965	5	3,134	1975	15	1,923	1985	25	1,180
1966	6	2,984	1976	16	1,832	1986	26	1,124
1967	7	2,842	1977	17	1,745	1987	27	1,071
1968	8	2,707	1978	18	1,661	1988	28	1,020
1969	9	2,578	1979	19	1,582	1989	29	971
1970	10	2,455	1980	20	1,507	1990	30	925
10 years		<u>\$30,882</u>	20 years		<u>\$49,838</u>	30 years		<u>\$61,473</u>

Crop Available Oct. 31	Time Elapsed (Years)	Present Value	Crop Available Oct. 31	Time Elapsed (Years)	Present Value	Crop Available Oct. 31	Time Elapsed (Years)	Present Value
1991	31	\$ 881	2001	41	\$ 540	2011	51	\$ 331
1992	32	839	2002	42	514	2012	52	316
1993	33	799	2003	43	490	2013	53	300
1994	34	760	2004	44	467	2014	54	286
1995	35	724	2005	45	444	2015	55	272
1996	36	690	2006	46	423	2016	56	259
1997	37	657	2007	47	403	2017	57	247
1998	38	626	2008	48	384	2018	58	235
1999	39	596	2009	49	365	2019	59	224
2000	40	567	2010	50	348	2020	60	213
40 years		\$68,612	50 years		\$72,990	60 years		\$75,673
2021	61	203	2031	71	124	2041	81	76
2022	62	193	2032	72	118	2042	82	72
2023	63	184	2033	73	113	2043	83	69
2024	64	175	2034	74	107	2044	84	66
2025	65	167	2035	75	102	2045	85	62
2026	66	159	2036	76	97	2046	86	59
2027	67	151	2037	77	92	2047	87	56
2028	68	144	2038	78	88	2048	88	54
2029	69	137	2039	79	84	2049	89	51
2030	70	130	2040	80	80	2050	90	49
70 years		\$77,316	80 years		\$78,321	90 years		\$78,935
2051	91	46	2061	101	28	2071	111	17
2052	92	44	2062	102	27	2072	112	16
2053	93	42	2063	103	25	2073	113	15
2054	94	40	2064	104	24	2074	114	14
2055	95	38	2065	105	23	2075	115	14
2056	96	36	2066	106	22	2076	116	13
2057	97	34	2067	107	21	2077	117	12
2058	98	33	2068	108	20	2078	118	12
2059	99	31	2069	109	19	2079	119	11
2060	100	30	2070	110	18	2080	120	11
100 years		\$79,309	110 years		\$79,536	120 years		\$79,671
2081	121	10	2091	131	6	2101	141	3
2082	122	10	2092	132	5	2102	142	3
2083	123	9	2093	133	5	2103	143	3
2084	124	9	2094	134	5	2104	144	3
2085	125	8	2095	135	5	2105	145	2
2086	126	8	2096	136	4	2106	146	2
2087	127	7	2097	137	4	2107	147	2
2088	128	7	2098	138	4	2108	148	2
2089	129	6	2099	139	4	2109	149	2
2090	130	6	2100	140	3	2110	150	2
130 years		\$79,751	140 years		\$79,796	150 years		\$79,820



The *present* value of the *future* income in a grouping consisting of decades is as follows:

**TABLE II**  
**Present Value of Future Annual Income**  
**of \$4,000, By Decades**

Decade		Dollars Per Decade	Cumulative
First,	1961-1970	\$30,882	
Second,	1971-1980	18,956	\$49,838
Third,	1981-1990	11,635	61,473
Fourth,	1991-2000	7,139	68,612
Fifth,	2001-2010	4,378	72,990
Sixth,	2011-2020	2,683	75,673
Seventh,	2021-2030	1,643	77,316
Eighth,	2031-2040	1,005	78,321
Ninth,	2041-2050	614	78,935
Tenth,	2051-2060	374	79,309
Eleventh,	2061-2070	227	79,536
Twelfth,	2071-2080	135	79,671
Thirteenth,	2081-2090	80	79,751
Fourteenth,	2091-2100	45	79,796
Fifteenth,	2101-2110	24	79,820
Total in 150 years		<u>\$79,820</u>	

An income of \$40,000 in the decade 140 to 150 years from now has a present value of \$24. That reveals the amazing discount for time at a modest 5% a year, a small percentage which the young and the unwise consider almost paltry and worthy of neglect.

The accumulative present value of the future income in 150 years is \$79,820.

Project the values still further into the future and the grand total will not amount to more than \$80,000 — presto, the very figure your wife arrived at by multiplying the \$4,000 annual income by only 20 years, a method which considers the annual yield to be 5% (obtained by dividing 100 by 20). It is obvious that the *method* of first dividing the interest rate into 100 gives a quotient, which can be used as a multiplier of the annual yield, which in turn correctly indicates what a property is worth, assuming that interest rate. Instead of laboriously making 150 divisions with a slide rule,

posting all the quotients and then adding them as was done in Table I, all that is necessary is to:

- (1) Divide the prevailing interest rate into 100.
- (2) Multiply the annual income by the quotient obtained from step (1).

But in order to *understand* what the *real* process is, it is necessary to compile a table as Table I. Compiling it for yourself will give you information which will astonish you.

Who would believe that \$4,000 today (1960) is worth only

\$2,455	if not received until	1970
1,507	" "	1980
925	" "	1990
567	" "	2000
348	" "	2010
213	" "	2020
130	" "	2030
80	" "	2040
49	" "	2050
30	" "	2060
18	" "	2070
11	" "	2080
6	" "	2090
3	" "	2100
2	" "	2110

Your surprise about this will be no greater than that of the writer.

It is an interesting fact that we in practice have a *short-cut* method that gives the correct result, but that few understand *in theory* what the substance of the reasoning is, to wit, that the value of land and other capital, the product of which is available only in the future, is determined by a discounting process, an evaluation system based on valuing lower what is available in the future.

Indeed, there is a factor of *productivity* — in our illustration, \$4,000. The size of that figure does affect the result. But the real problem is what the discount rate is, which gives the "multiplier," which in our illustration was 20.

What your farm will be worth, using your wife's sound method of short-cut calculation, will be as follows, at varying interest rates:

**TABLE III**  
**The Value of a Farm Yielding \$4,000 Annually,**  
**Depending on the Discount Rate**

Annual Income From Farm	Discount Rate (%)	Value of Farm*
\$4,000	3%	\$133,333
4,000	4	100,000
4,000	5	80,000
4,000	6	66,666
4,000	7	57,144
4,000	8	50,000
4,000	9	44,444
4,000	10	40,000

If the computations performed in order to obtain Table I were performed by using varying discount rates as in the foregoing (that is, divisions by 1.03, or 1.04, or 1.06, etc.), then the value of your farm would be the figures in the last column in Table III.

In other words, *the value of your farm depends in part on the yield but more on the discount rate. Presumably, in a stable economy, the yield annually from the farm will average about the same without variation over a period of years; (we assumed \$4,000). That leaves the other factor, the discount rate, as the volatile variable. That discount rate, as has been shown, gives the clue to what the farm is worth. The discount for time is more important in determining the value of your farm than yield.*

A 1% variation in the discount rate may appear to be a trifle, from say 3% to 4%. But the paltry 1% change will have a large consequence. As Table III shows, it involves a difference between \$133,333 and \$100,000, or \$33,333, merely because the discount rate changed from 3% to 4%.

\*       \*       \*

Obviously, when pricing land (or other capital) the one-year net yield (\$4,000) is a factor. But the other factor, the multiplier, is 20 or 10 or 30 times more important, because it is the *multiplier* applied to one year's net yield. Where basically do we get the *multiplier*? From dividing (in the illustration used) the *Total* in Table I by \$4,000, that is,  $\$79,820 \div \$4,000 = 20$ ; or more accurately, in perpetuity,  $\$80,000 \div \$4,000 = 20$ . And behind

\* Figures obtained by multiplying  $(4,000 \times \frac{100}{\text{interest rate}})$

it all there is a *psychological phenomenon* — *the discounting of what is in the future*.

For a *comprehensive* treatment of the explanation of originary interest, see Böhm-Bawerk's CAPITAL AND INTEREST, Volume II (*Positive Theory of Capital*), Book IV, pages 257ff.

## Most Important Price In The World

The most important price in the world, far outranking any other price, is the "discount of the future," a discount determined by the aggregate of the people in a community. The price to which reference is being made is (1) the "cost" of borrowed money, (2) the prevailing rent on land, and (3) the prevailing return on capital; that is, the reference is to originary interest.

If present goods are in *urgent* demand, then the originary interest rate will be high, because a considerable amount must be added to future goods to make them equal, in the prevailing estimation of men, to present goods. In a poor society the need for present goods will be urgent. And so in a poor society interest rates will be high.

If a society is already opulent and people are already generally living comfortably or even luxuriously, then originary interest rates will be low, because people will be willing to wait more patiently for future goods and will not insist that a high premium be added to future goods to make them equal to present goods.

Originary interest rates are lowest in Western Europe and in the United States, areas where capital is relatively plentiful. Interest rates are highest in the backward nations of the world. They are often twice as high, or higher, in backward nations than in the most advanced.

It would be expected, if the theorists obsessed with the alleged exploitation by capitalism were right, that the more advanced capitalistically a country is, the higher the originary interest rate would be, on the assumption that it would be evidence of greater exploitation, because there was more capitalism. The figures indicate the contrary. The more advanced the capitalism, the lower the charge — the price — for equating what is in the future with what is in the present.

The rate at which capital is accumulated is affected by the "discount rate" between future and present. The balance wheel of society — how it balances off future against present — is the

discount rate. The discount rate "arbitrates" between present and future generations.

The price of gold, wheat, securities on the New York Stock Market, copper or cotton are all relatively unimportant compared to the originary interest rate, or discount rate.

## Attempts At Tampering With The Originary Interest Rate

The activity of tampering with — controlling — the originary interest rate — something that cannot really be accomplished — has been assigned by the people of the United States, legislating through their Congress, to the Federal Reserve Board. This is the most dangerous economic program that is being attempted in this country. One device of the Federal Reserve Board to effectuate the assignment is to vary the *rediscount* rate, that is, to vary the rate at which member banks in the Federal Reserve System can borrow from their regional Federal Reserve Bank.

The originary interest rate is a consequence of the wishes, plans, and actions of *all* the citizens — savers, spenders, shortsighted people, farsighted people, the courageous, the timid, every consumer, every businessman. How in total these all "discount the future," and consequently determine the discount rate, is a massive, relatively inert phenomenon. Attempts to control or play around with the rediscount interest rate must collide, sooner or later, with this actual rate, and then which will prevail?

Suppose, in order to stimulate business and consequently employment, the Federal Reserve Board lowers the rediscount rate below the originary discount rate. That means that businessmen who make decisions on the basis of the *quoted rate* will believe that the public is prepared to postpone consumption more, to allocate more of present consumption to a delayed consumption, that is, that businessmen can expand their operations, build more plants, buy more machinery. The lowered, quoted discount rate is *assumed* to be evidence that the future can be taken care of better, because the present is so good already; and that therefore only a lower rate needs to be added to future goods to make them equal to present goods; in other words, the assumption is that the real originary interest rate is as low as the artificially lowered rediscount rate.

The purpose of tampering with the rediscount rate is to stim-

ulate the industries that are known as capital-goods industries. These are the industries that expand when the populace is prepared to allocate to the future a larger share of present effort, an allocation consisting of building plants and equipment that will not yield their full return until decades into the future. The extent to which the public is prepared to do that is truly revealed by the ordinary interest rate — the higher the rate, the more people are neglecting to pay attention to the future; they do that by demanding a big addition to the price of what is to be available in the future, compared with the present; in order to be willing to hold off consuming something now in order to obtain something else that will be available in the future, they demand, say, 10% extra because it is available only in the future; that is the high ordinary interest rate that they demand in order to raise future values to present values for themselves. Or they may, contrarily, be prepared to accept a lower addition to what is available in the future in order to make it equal to the present, that is, the ordinary interest rate is genuinely lower. They might then ask only a 3% addition annually to make future values equal to present values. Such an event would result in businessmen expanding their productive capacity, because the cost to supply the future had been lowered to 3%.

The capital goods industries are, then, properly constricted by rising ordinary interest rates, and unleashed by declining ordinary interest rates.

The presumptive theory in the United States is that the Federal Reserve Board can *arbitrarily* affect the ordinary interest rate by its own rediscount rate changes — changes unrelated to the real intention of John Public.

John Public understands little of all this. John Public continues to go his fairly steady way in regard to future versus present. He does not necessarily have in mind a shift from present goods to future goods, as those who conduct their course by the decrease of the rediscount rate of the Federal Reserve Board think will occur. The new plants may be built, but the public may not be prepared to allocate so much to the future; they may want present goods, not future goods. The new investments then prove to be uneconomic; the plants cannot be completed; the product cannot be sold; businesses are blighted or they fail. Then there is a depression. Instead of creating stability and prosperity, the statute under which

the Federal Reserve Board is operating (ostensibly to promote stability and employment), actually is a cause of instability.

The consequences of unsound financial policies, executed by the Federal Reserve Board in compliance with the law of the land, have been concealed under a series of inflationary steps. Most recently (summer of 1960) these inflationary steps have consisted in easing member bank reserve requirements. Either of two consequences of the present financial policy of this country is inescapable — either inflationism or a depression. It will probably eventually be both — first inflationism and finally a depression.

The grand strategy of unsound financial policies in the United States consists in tampering with our most massive, irresistible economic phenomenon — the appraisal by all men of present versus future. The ultimate consequence may be an economic, political and social revolution, as “earth-shaking” as the French Revolution.

The United States today is an *opulent* society, but it is not a *soundly prosperous* society. Political campaigning is going on in connection with the four-year election of a president. The platforms of both parties endeavor to entice voters by promises of greater prosperity. To be able to do that, it will be necessary to return to first principles in morality and economics. Neither of the parties is prepared to do that. Efforts to influence the originary interest rate must be abandoned.

What the people of the United States “want” — although the average citizen may not be able to formulate a specific program for himself — is a program that promises stable prosperity rather than boom opulence. A secure prosperity cannot be attained by tampering with bank rediscount rates in order to have them affect the originary interest rate.

### **Originary Interest (Or Discount) Must Not Be Confused With Gross Interest**

There is, as has been stated in earlier issues of *FIRST PRINCIPLES*, no “quotation” of the originary interest or discount rate. In a sense, the concept of originary interest is an abstraction.

The actual interest rate being paid, in a given case, will contain:

1. The originary interest rate.
2. An additional amount, as a hidden insurance premium, to compensate the lender for the risk that the borrower may not repay.

This premium may be infinitesimal or it may be large (to compensate for a loan being very risky). This part of the interest rate is not interest in an economic sense, but an insurance charge.

3. An adjustment for expected increases or decreases in the prices of goods. This factor is associated with the changing ratio of money to goods and services, especially as a consequence of inflation (the immoral increase of the money supply by the issuance of fiduciary media). If a man loans \$1,000 today to another, but has conclusive grounds for expecting that a year hence, when he is to get his \$1,000 back, prices will be 5% higher, then he will demand as an interest rate, not only 5% originary interest, and an insurance premium (a small percentage maybe, say  $\frac{1}{8}\%$ ), but also another 5%, that is, 5% plus  $\frac{1}{8}\%$  plus 5%, or  $10\frac{1}{8}\%$ . Contrarily, if it is *sure* that prices will drop 5%, then the formula will be 5% plus  $\frac{1}{8}\%$  minus 5%, or  $\frac{1}{8}\%$ ; in other words money will carry a lower gross rate of interest under such circumstances.

4. Finally, there is a "bargaining" factor; a lender may be demanding and overcharge, and a borrower may be imprudent; *that* may result in the rate being higher than "normal." Vice versa, the lender may underprice and the borrower may be more astute; that may result in the rate being lower than "normal."

But the solid, relatively steady factor in the gross interest rate will be the *originary* portion of it.

\* \* \*

Originary interest as a generic term includes rent and profits. Here, too, the solid, relatively steady constituent item (in rent and profits) is the originary portion of it. But these forms of "interest" are also responsive to the same factors of risk premium, price trends up or down, and "bargaining," and the actual rent and profits rates will reflect that. In the case of rents and profits the "extraneous" factors of insurance, price trends, and bargaining skill are more variable. For example, profits may be extraordinary, say 20%; but they can be the reverse; instead of any profit there may be a loss of 20%; or even of the whole investment.

The "play" of actual or gross rates above and below the originary rate may appear confusing, and may incline some to ignore the "hard core" of originary interest in the published interest rates, but to do so is to fail to understand the essence of "interest," as the term is used in the science of economics.



In the illustration used earlier (the \$4,000 rent on a farm), it is, of course, unrealistic to consider the rent of the farm *fixed* at exactly that amount. The rent will fluctuate, as do all things in life. But *that* will not affect the interest or discount rate, but the price of the farm. In other words, variations in productivity affect the price of the principal amount and not the discount rate. If the productivity of the farm rises to \$6,000, the price of the farm goes up — that is, the price goes up enough so that the “yield” is back to 5%; in other words, the farm then commands a sale price of \$120,000; the discount rate remains unchanged at 5%; for when the 5% is applied to \$120,000, the answer is \$6,000.

Productivity in a business affects the price at which investors “capitalize” the business, but not the originary interest rate.

It may appear to be unfortunate that the *published* interest, rent and profit *rates* contain a number of items which are not “pure interest,” but there is no avoidance of the problem. If analysis of the return on capital is to be revealing, the constituent items in the gross interest rates must be separately considered. The most important item to “abstract” from the total is *originary* interest.

### A Good Book: “Essays In European Economic Thought”

Occasionally, a singularly good book of essays is published, and this is one of them.

The authors of the respective essays are Carl Menger, Friedrich von Wieser, Ludwig von Mises, Paul Painlevé, Jacques Rueff, Ludwig Pohle, Luigi Einaudi.

Menger’s name is one of the greatest in the history of economic thought, and he was founder of the Neoclassical school of economics. Here there is made available in English for the first time one of his outstanding essays, “A Systematic Classification of the Economic Sciences” (1889).

Maybe the best thing that Wieser ever wrote is his, “The Theory Of Urban Ground Rent” (1909). This is the second article in the book.

The article by Pohle carries the title, “A Critical Examination of Current Doctrines Concerning Wage Rates and Unionism” (1912).

The brief essay by Mises, greatest of living economists, carries the title, "The Nationalization of Credit" (1929).

Painlevé, late premier of France, is represented by an essay, "The Place of Mathematical Reasoning in Economics."

Rueff is a distinguished Frenchman, and outstanding economist. He is a judge at the Court of Justice of the European Coal and Steel Community. He is influential in the De Gaulle administration. He is a man who may yet be able to do for the financial and economic welfare of France, what Ludwig Erhard has already done for Western Germany. Rueff's essay carries the title, "A Letter to the Advocates of a Controlled Economy" (1949).

The last essay is by Einaudi, statesman and economist, who served from 1948 to 1955 as president of the Italian Republic. The striking title of Einaudi's contribution is "The Doctrine of Original Sin and the Theory of the Elite in the Writings of Frédéric LePlay." We shall give this article special attention for reasons which will become apparent in the following article.

Einaudi apparently has written a series of essays on books in his library. He has figuratively "toured" his own library.

The author of the books and ideas discussed by Einaudi in this essay is a French engineer, named Frédéric LePlay, who worked — of all subjects! — on family budgets. LePlay wrote books (reports) on his findings, and inspired others to engage in similar research and write similar books. The subject sounds prosaic and even boring, but it is not, as Einaudi's delightful essay amply substantiates. Einaudi himself appears to be genuinely "sympathetic" to his subject, LePlay, and to LePlay's ideas.

Add to "family budget statistics" the Christian religion's idea of "original sin" (as the title of Einaudi's article indicates) and you have a combination of statistics and religion from which most people will shy away with alarm.

This reviewer, however, has read few things recently which has pleased him more than LePlay's ideas. LePlay was no woodenish statistician nor naive "believer." He addressed himself to crucial questions; he asked, according to Einaudi:

Why is a man — and he means a man of the people, the peasant, the laborer, the miner, the foundry worker — satisfied or dissatisfied? Why does he wish either to change his position or to remain where he is? *Why is one society prosperous and stable and another unstable or disorganized or corrupt?* [Our italics.]

Questions as the earlier ones in the quotation are interesting and significant, but questions as the last — what makes a “society prosperous and stable” — are crucial.

We lack space to define LePlay's terms or summarize his argument, but his answer has two facets:

1. Men are *not* naturally good; men are not corrupted by society, as Rousseau taught; the evil in society stems from men themselves — their co-complicity in original sin, and their natural depravity. On this point Einaudi quotes LePlay who in turn quotes St. Augustine in regard to a small infant's rage against and jealousy of another infant. Augustine, in the passage quoted, indicates that when Christ took a small child and used it as an illustration in the statement, “Of such is the Kingdom of God,” he could not have referred to the spiritual goodness of the child nor its humility, but merely to the smallness of its physical stature. It was that physical smallness which was a good illustration of humility, not the soul of the child, because that (according to prevailing Christian doctrine) is not good, but tainted and depraved. LePlay, therefore, rejects, as a starting point for a philosophy of the nature of man, any idea of man's innate goodness. Man's original nature does not make society prosperous or stable.

2. *For a society to be good and stable it must be based on the Decalogue.* Einaudi describes LePlay's views as follows:

... the positive criterion of the prosperity of a society under the rule of the elite is the extent to which the Decalogue is observed: the worship of God and the prohibition of idols; the honor accorded to parents, and the observance of the injunctions against taking the name of God in vain, killing, stealing, giving false testimony, committing adultery, and coveting the goods of another. These are the rules whose observance in private and public life leads a people to prosperity, and whose violation leads it to ruin. LePlay made individual studies of hundreds of families under the most diverse conditions — physical, historical, and political; scrupulously analyzed the material and intellectual circumstances of their lives; and, in seeking the basic causes of happiness and of unhappiness, of prosperity or poverty, he invariably referred to the Decalogue and studied the attitude of men towards its specific commandments. This is the magic key that opens to us the secrets of a people's history.

Those two principles of LePlay: (1) man is not by nature good, and (2) he must conform to the Decalogue in order to get

along well, are also basic principles in FIRST PRINCIPLES IN MORALITY AND ECONOMICS.\*

Conservatism and traditionalism do not make a society prosperous. Liberalism and progressivism do not make a society prosperous either. There is another ingredient which it is necessary to associate either with conservatism or liberalism, and *that ingredient is conformity of conduct on the part of the members of a community to the Law of God.* (See the next article.)

Most of the contributors to this book are liberals — grand and distinguished liberals. They are champions of freedom, which is marvellous. But what makes the book, *Essays in European Economic Thought*, so unique and so balanced is the fact that it contains an article which summarizes so admirably what *must* be added to freedom in order to make it tolerable, namely, restrictions which restrain a man (while exercising his own freedom) from injuring his neighbor. As Sallust proudly and maybe boastfully said of the contribution of Roman conquerors to the vanquished, the Romans restricted those whom they had vanquished no more than that they thereafter were *prevented from doing wrong*. Similarly in order to have a good and stable society, freedom must be harnessed into a team; the other necessary “horse” consists in conformity to the Decalogue — restraint against indubitable, specific evils.

The publisher of this book is the D. Van Nostrand Company, Princeton, New Jersey. The price is \$6.00. Dr. Louise Sommer is translator and editor. It should be added that this book is one of The William Volker Fund Series in the Humane Studies. From the books already published in this series the expectation may be formed that this series will be a remarkable one.

## Conservatism, Liberalism, Law-Liberty, Collectivism and Philanthropism

1. *Conservatism* as a philosophy of life has merit, but it is not possible for FIRST PRINCIPLES to be “conservative.” Times and circumstances change, and the solutions of problems require that new facets be taken into account. Friedrich von Hayek has excellently stated the case against conservatism in his lecture, “Why

\* (That does not, however, commit us in any way to the error of Job’s friends, nor make us unaware or indifferent to the necessity of the phenomena of grace.)

I Am Not a Conservative," given some years ago at a meeting of the Mt. Pelerin Society.\*

2. *Liberalism* appeals to us much more. We are prepared to run the risk of changing with changing times; of letting each man follow his own bent and regulating his own life. We are opposed to attempted compulsory uplift by group or state action. If a man wishes to eat too much, play too much, risk too much, that is "his privilege." We should try to educate him away from living unwisely, but if he will not listen, we wipe the "dust of responsibility off our shoes" and pass on. We reject the alternative — that we can tell a neighbor individually that he *must* reform his manner of living, or that we tell him collectively that he *must* live as we want him to live. We are opposed to *uplifting* him compulsorily; leave him his *liberty* or *freedom*, and if need be let him waste *his* life, destroy *his* future, blight *his* opportunity.

The dynamism in society — the chance and prospect of progress — depends on such freedom by individuals. To freeze everything by conservatism may keep a society from sinking fast, but it will also prevent it from changing and maybe improving.

The theme song of liberalism is liberty, one of the marvelous words in language.

3. In contrast to Conservatives and Liberals, we are *Decalogue men*. We believe society should be founded on the Law of God and not on liberty. This does not commit us to endeavoring to apply puritanical restrictions to other people. As has just been explained, there is a time to wipe the dust of responsibility off one's shoes. We concur with what the Christian religion teaches, to wit, that we are not our "brother's keeper." We believe that a man should be permitted to ruin *himself*, if that is his determination — if he will not listen to advice and admonition. *He should not have free rein to ruin others; that is where the Decalogue comes in.*

The Christianity that is dangerous is the kind that will not wipe the "dust of responsibility" off its shoes, but instead has recourse to trying to *coerce* people into being good. There are two kinds of notes sounded in Scripture; one is, to drag the converts in; but the other is, to tell people the gospel, and then leave them to

\* The lecture is reprinted as a Postscript in his new book, *The Constitution of Liberty*, The University of Chicago Press, Chicago, 1960, p. 397ff.

their own devices; *Scripture never recommends recourse to compulsion after persuasion fails.\**

In FIRST PRINCIPLES we are committed to the proposition that a man should not be permitted to try to pull himself upward by dragging someone else down. Society is, therefore, in our book, founded on certain prohibitions, especially (1) the prohibition against coercion (thou shalt not kill, maim, engage in coercion — the Sixth Commandment in the Decalogue); (2) the two prohibitions against theft of mate or of property (thou shalt not commit adultery, and thou shalt not steal — the Seventh and Eighth Commandments, respectively); and (3) the prohibition against deception and fraud (thou shalt not bear false witness — the Ninth Commandment). Instead of compelling people to submit to being lifted up, and by so doing being “uplifters,” we are in favor of preventing people from being “down-draggers” of others. For that purpose we believe the law should be used. The law is to restrain evil, and not to compel to do good. The law should go no further. In fact, the Hebrew-Christian moral law relies on *compulsion* only to restrain evil, and on persuasion *only* in order to accomplish doing good. This is a vital distinction.

4. There is a fourth category — *collectivism*. Collectivists are not conservatives, nor liberals, nor Decalogue men. They are would-be demi-gods, who are so sure that *they* know what is good for others, or who at least love power for themselves so much that they believe government should be conducted according to *their* ideas — whether those are selfish or altruistic. These people may be the worst kind of rogues — men of violence and evil; or they may be fanatic idealists, promoting a sanctimonious ethic. But, in any event, they are *exploiters* of others, in the sense that they are

\* The incident recorded in the New Testament which substantiates that is well known; Matthew, Mark and Luke all record it. Christ was giving instructions to his disciples as he was sending them on a preaching tour. He said (Matthew 10:14):

Whosoever shall not receive you, *nor hear your words*, as ye go forth out of that house or that city, shake off the dust of your feet.

Not only does this forbid having recourse to coercion after persuasion has failed, it even sets a termination point to persuasion! People who profess the Christian religion will do well to note the position taken in this instance. Elsewhere in Scripture there is strong language advising not to “throw pearls before swine.” The emphasis in these cases is on what Christ wanted his disciples to do and not to do; *the corollary is the complete freedom of hearers; they were to retain their uninhibited liberty.*

prepared to insist that *their own* ideas prevail by force when necessary. Collectivists cannot conform consistently to Christian ethics.

5. There is a fifth category of people, who take on the cloak of high religion and declare that sacrificing the self for others is the rule on which society must be founded. They teach that the highest ideal is *philanthropy*, based on *agape*. (See Volume III, pages 181-182; Volume IV, pages 306-309; and Volume V, pages 374-384.) These people are some of the most dangerous in society, and among the most subversive. They would found society on *beguiling but destructive charity* rather than on *noncoercive, constructive cooperation*. They do not realize adequately that charity is usually damaging to the recipient; and they have no understanding whatever of — have never even heard of — Ricardo's Law of Cooperation, which makes clear the inescapable *mutual* benefits of *cooperation*. (See Volume IV, pages 200-224; 229-255; 259-264.)

\* \* \*

We cannot unite with Conservatives or Collectivists, nor with those who are philanthropists and are fanatics for "brotherly love" or "charity;" but under certain conditions we can unite with Liberals.

Liberals believe in freedom; supplementary to that they usually assume adherence to the Decalogue, or at least the Sixth, Eighth and Ninth Commandments. But while they emphasize liberty, many of them are more or less silent about the "Law." It is that silence about the Law that exposes them to suspicion and critique by others. Why should not a man, instead of merely eulogizing and claiming liberty, also not eulogize and embrace the Law of God as expressed in the Decalogue?

We do not here refer to law *in the abstract*, as something that is restricted to being a uniform rule for everybody, the strong as well as the weak, the ruler as well as the ruled. That is, indeed, a "rule of law" of sorts. But it is not a *specific rule* of law. It does not so much concern itself with the *content* of the law, as with the *application* of the law. Not that such an idea of uniform and invariable application is not good; it is; but it does not go far enough. Such advocates of "rule of law" trust in a law arrived at empirically — by experience — and they trust that further experience will make the law tolerable, because everybody will be "under" it, and if it is not a salutary law, then "experience" will see to it that whatever

is burdensome in the law is corrected. But the idea of a *revealed* law, or a law *already fully validated by experience* — a Law as the Decalogue — that is a concept of Law which some Liberals will not accept, or if so only tacitly.

On the basis of the foregoing, Liberals who are silent about the Law, may exclude us from the status of being *liberal*; we may not be “liberal” enough. But how much liberty does Christian ethics permit a man to have? To that the answer is: *all liberty any right-minded man should ever want.*

Is there improper restraint on a man by Christian ethics? Not as we see it. Hebrew-Christian law goes no further in restraining liberty than prohibiting men from doing wrong.

\* \* \*

Advocates of Christian freedom have been as derelict in stating their *whole* doctrine, as have been those liberals who emphasize freedom but are silent on the moral law (the Decalogue).

A typical representative of sound Christian ethics (not the man who presents a perversion of Christian ethics as in the paragraph foregoing, numbered 5) often neglects to present his full doctrine. How should he formulate it? Something like this: you may not perpetrate the evils forbidden in the Decalogue, *but all else is free, do what you please, live as you wish, possess your birth-right of liberty without other inhibitions.*

If the question is asked, how big is such an area of liberty and how big is the area of prohibition, we would say that the former is 95% and the latter, 5%. The area of freedom, the area beyond the restraint of the Decalogue, is boundless, illimitable for any man, except as he is a finite being. (See Volume I, pages 54-78.)

A Liberal then, in the best sense, is a man in favor of liberty, supplemented by an explicit moral law.

A Christian moralist then, in the correct sense, is a man in favor of the restraint of the Hebrew-Christian moral law, supplemented by freedom.

In FIRST PRINCIPLES we represent Law *and* Liberty in the senses just defined. Our position is not described in terms of liberty only nor law only, but law *and* liberty. Our position might be called that of law-liberty.

In conclusion, when we have chosen for an “order” for society based on the Decalogue, that is, on the Hebrew-Christian Law of



God, then we have chosen maximally for liberty, because we have left all men *free in everything, except* that in the field of ethics they are forbidden to injure others by coercion, theft and fraud. That is a liberty based on law, and may properly be described as law-liberty.

It is because the book reviewed in the preceding article has such a fine selection of essays — fine because *both liberty and law* are emphasized in one or more of them — that we have commended the book so highly; Einaudi, using LePlay's ideas as his subject matter, has most admirably called attention to a phase of liberalism which needed emphasis. At least, it is a phase of liberalism which we in FIRST PRINCIPLES consider a necessary part of liberalism.

Indeed, what is more true than that no one ought to be so foolishly proud as to think that, though reason and intellect exist in himself, they do not exist in the heavens and the universe, or that those things which can hardly be understood by the highest reasoning powers of the human intellect are guided by no reason at all? [Page 389.]

In truth, the man that is not driven to gratitude by the orderly courses of the stars, the regular alternation of day and night, the gentle progress of the seasons, and the produce of the earth brought forth for our sustenance — how can such an one be accounted a man at all? [Page 389.]

For the man who rules efficiently must have obeyed others in the past, and the man who obeys dutifully appears fit at some later time to be a ruler. Thus he who obeys ought to expect to be a ruler in the future, and he who rules should remember that in a short time he will have to obey. [Page 463.]

For it is not so mischievous that men of high position do evil — though that is bad enough in itself — as it is that these men have so many imitators. For, if you will turn your thoughts back to our early history, you will see that the character of our most prominent men has been reproduced in the whole State; whatever change took place in the lives of the prominent men has also taken place in the whole people. [Page 495.]

—MARCUS TULLIUS CICERO  
*Laws* (Loeb Classical Library)

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## It Is Not Difficult: Make Your Descendants Rich

You might consider making your descendants rich. It is, in a sense, so feasible for you to do so, that FIRST PRINCIPLES IN MORALITY AND ECONOMICS might be considered derelict if it did not call to your attention that you can assure wealth, and maybe social standing, prestige, culture and leisure to your descendants in the future, *almost effortlessly*. That being the case, why should you not take the simple steps necessary to do that for your beloved children?

\* \* \*

For you to understand the problem without difficulty, you are referred to an article in the previous issue, pages 267-275, which carried the title, "How Men Avoid Overpricing Land." In that article, there are three tables which show how much less people value something available *in the future* compared with the same thing if available now. Economic goods available in the future only are *discounted*. We used an interest rate, or discount, of 5%. The principle involved requires that the interest or discount be compounded annually.

Table I showed that \$4,000 when not available until 150 years

from now, if discounted at 5% annually, is worth only \$2.65 now. See Table I, page 270. The corollary way of saying the same thing is that \$2.65 invested to yield 5%, compounded annually, amounts to \$4,000 in 150 years.

Table II shows that \$40,000 available in ten \$4,000 instalments in the decade 2101-2110 — that is, 140 to 150 years from now — is worth only \$24 now. The corollary to that is that saving a total of \$24 in ten instalments in the next ten years, 1961-1970, will amount to \$40,000, at 5% interest, compounded, in the year 2110, that is, 150 years from now. It is difficult to believe, but so it is.

Tables I and II in the September issue from which the figures are taken, merely presented figures in reverse from the usual manner. The tables show what *discount* there must be now for a sum of \$4,000 available at later dates. Ordinary interest tables would show how much a present sum would “increase” at 5% compound interest. In the first case we discount for the future; in the second, we accumulate from the present. Essentially, the process is the same, except that the *starting points* are different. (See page 217ff. in the July issue.)

\* \* \*

The ratio between \$4,000 in 1960 and \$2.65 in 2110 (150 years away) is 1,508.53 to 1. Suppose you earn \$100 a week, and that you decide to put that one week’s wage or salary into an investment which will earn 5% annually for 150 years. That will amount to  $\$100 \times 1508.53$ , or \$150,853 in the year 2110. This increase from \$100 to \$150,853 is the result of compounding the 5% income for 150 years.

\* \* \*

The ancient Hebrews figured a generation at 40 years. It is from there that the expression comes that Moses was 40 years in Egypt, 40 years in the Sinai Wilderness, and 40 years at work on the Exodus of the Hebrews from Egypt. The idea is that he was in Egypt the equivalent of one generation; in Sinai another generation; in the Exodus during another generation. If we use 40 years to indicate a generation, then 40 years divided into 150 years

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gives a quotient of almost 4; that is, 150 years hence your great-great-grandchildren will be about 30 years old. Put \$100 away now, for each of them (you probably do not know how many great-great-grandchildren you will have), and if 5% interest accumulates uninterruptedly, then they will have \$150,853 each.

To insure the execution of your plan you would be obliged to instruct your children, your grandchildren, and your great-grandchildren to leave the investment undisturbed, and your great-great-grandchildren should leave the sum undisturbed until they are 30 years old.

Would it not have been thoughtful of one of your own great-great-grandfathers if he had invested \$100 as recent as 150 years ago, and that you would find yourself in your own lifetime the recipient of \$150,853 when about 30 years old?

\* \* \*

If you will make arrangements for the next succeeding generation thereafter — your great-great-great-grandchildren — that is, if you add 40 years to the 150, then *that* generation would receive \$1,060,394. In other words, each individual \$100, in 190 years, at 5% compound interest, will grow to be \$1,060,394.

Everybody has sixteen sets of great-great-great-grandparents. If each set of such grandparents had invested \$100, only 190 years ago, then you as their great-great-great-grandchild would get \$16,966,304 from such investment. It appears that these ancestors have been "neglectful" of their descendants now, five generations hence.

\* \* \*

Animals are protective, and apparently fond of their offspring, but only as long as the latter need the protection of the parents. Then the bond seems to dissolve completely.

Men are in that respect different from animals in degree. Most people do not know the names of their great-great-grandparents, their employment, their location, their character, their achievements. Further, few people seem to care much about their great-great-grandchildren, and even less of descendants further removed.

Most people do not have one sheet of paper with a line of writing on it from their great-great-grandparents. Equally few write something today with the intent that it will be available to their great-great-grandchildren.

Men and women care little more — if observation is reliable — for their great-great-grandchildren than animals do for their first descendants when the latter have reached maturity; that is, their care is almost nil.

Grandparents like their grandchildren to be around some, but usually only a little. A devoted grandmother will say, "I took care of my children when they were small. Now it is the turn of my children to take care of theirs. I'll do some babysitting, but not a lot."

Many people may prefer to spend that \$100 for themselves rather than investing it for their great-great-grandchildren.

\* \* \*

The law of the land hampers financial provisions for distant grandchildren. If you decide to create a trust for your descendants, it cannot have a continuation much beyond the life of individuals presently living. The law varies by states. The law may read that investments may not remain intact in a trust for more than 40 years beyond the life of individuals presently living, that is, one generation further (the 40 years being taken apparently as "one generation" as was the ancient Hebrew custom).

\* \* \*

The tendency is for families to rise above the mass for one generation only, infrequently for two generations, and rarely for three generations; the colloquial expression is "from shirtsleeves to shirtsleeves in three generations." The exceptional individuals bob up, but exceptional qualities do not descend uninterruptedly from father to son and mother to daughter. And so, families rise and fall.

To hold a family in a superior position for many generations has required special laws, especially the law concerning entail which determines the succession of landed estates so that they cannot be bequeathed at pleasure by a representative of one generation in the chain. To hold the principal intact — that is, the land — the estate usually was required to go to the eldest son or child (by right of primogeniture). The property could not be "broken up" and distributed to all the children. Younger sons and daughters were required to shift for themselves as well as they could — in government work, in the church, in the professions,

and even in business. The problem for the girls was to marry well.

In fact, the problem may not be so much the ability to earn 5% interest year in and year out, and to reinvest it equally well; the problem most people may have is to keep their principal intact. The entailing of landed estates was designed to protect the principal rather than to insure a 5% income.

A family which keeps its principal intact and averages to earn 5% interest on its investments for four or five generations is a truly remarkable family.

\* \* \*

The Fuggers in the Middle Ages were great bankers. The hope that their later generations would have the ability to operate profitably in the banking business, as the founders had been able to do, could not be evaluated otherwise than as a chimerical hope. The Fuggers "survived" by marrying into the aristocracy, and getting the descendants into the soberer business of retaining landed estates, under the law of entail, an activity less hazardous than being in the banking business.

The modern American counterpart of the Fugger program is to withdraw investments from competitive, volatile businesses, and reinvest in downtown real estate in big cities. That has gone on in a substantial way in big American cities; for example, from oil to a business "center"; from (department store) retailing to office buildings; from malting to suburban shopping centers. Dwellers in the large cities in America will immediately be able to think of examples of this kind in their own city.

\* \* \*

It is then easy, or at least possible, to make your distant descendants rich, (1) if you can foreknow how many you will have; (2) if you set \$100 aside for each of them now; (3) if the investment is safe as far as the principal is concerned; (4) if the income averages 5% for a century and a half or more; (5) if your descendants, under contract and/or by choice, refrain from spending the sum for noninvestment purposes, but instead reinvest to obtain 5%; and/or (6) if the laws of the state in which you live permit you to make provision into the future for such a distant time.

\* \* \*

The writer does not know of a case, among his friends, of a man who has devoted thought to make provision for a descendant as far removed as a great-great-grandchild. This is evidence how

extensively we all "discount" the future. Only the most remarkable people concern themselves about their *distant* progeny.

The patriarch Abraham was a great man in his own right. But he was aware that his "greatness" essentially depended on the numbers and quality of his descendants. He was not a mere animal; nor a one-generation human being; he gave thought and had an interest in his progeny in *remote generations*. He was a monotheist; he had faith; but his greatest *practical* uniqueness rested in his concern for his offspring, as long as the world lasts. That was *uniquely remarkable*.

### What In Essence Is Meant By "Capitalizing The Income"?

Farm land is rather commonly priced at 20 times the annual net rent (or annual net yield). If the annual net rent of a farm is \$4,000, then that net rent is "capitalized" at \$80,000; that is, the percentage net yield is 5%, because 5% of \$80,000 is \$4,000.

Other net yields — on bonds, mortgages, business ventures — are "capitalized" on a similar basis. But there are large variations between industries, between one country and another, and between companies in the same industry.

Government bonds are "capitalized" presently at more than 25 times the annual yield. Common stocks of food companies are capitalized approximately at 16 times earnings; stocks of oil companies at 10 times earnings; and stocks of market favorites, as International Business Machines, at as much as 66 times earnings.

What are people really doing when they "capitalize" earnings? And why the radical variations — 20 times earnings, 25 times earnings, 10 times earnings, or 66 times earnings?

#### What Is Meant By Capitalizing Earnings?

"Capitalizing earnings" seems to mean "setting a price determined by the number of years in which you expect to get your capital back via the income." If you pay 20 times annual earnings for land, then you think you will get your capital back in 20 years, and as far as dollars are concerned you will, but you will not get that *value* back. You will get the *value* back only after more than 150 years; see the preceding issue, pages 271 and 272.

People seem to accept that the multiplier, 20, is the figure with which men do and should begin their computations on capital-

ization. The fact, however, is that they begin (whether they are conscious of it, or not) with the 5%, which is the "complementary" figure to the 20; the 20 was obtained by dividing 5% into 100. The crucial question is — *from where do people get the 5%?*

If *A* loans *B* \$80,000, then *A* wishes to get his principal back sooner or later. He may want it back in one year; but *B* actually pays him back \$80,000 plus interest at 5%, or \$4,000, a total of \$84,000. Why the "extra" \$4,000? The answer is that both *A* and *B* more or less understand that the \$80,000 a year from now is not valued as highly as \$80,000 now. In order to pay back what people evaluate equally, \$84,000 must be paid back a year hence in order to equal the \$80,000 now. (At 5% interest a dollar a year from now is presently valued at only 95/100ths of a dollar; therefore, more dollars must be paid back a year hence in order to equal \$80,000 now.)

Let us shift from one year (from \$84,000 and \$80,000) to perpetuity. Then, the idea must be that the principal of the loan will not be *fully* repaid until eternity. What will come back to the lender is a stream of dollars with shrinking value, a stream strung out over the interminable years, until the Day of Judgment. *That* is the way toward understanding how the whole \$80,000 of *value* is to come back to *A*, the lender. In 150 years, \$600,000 in *dollars* will come from the farm, but only \$79,820 in *value* (see Table I, page 270). *A* and his children may collect equal instalments of \$4,000 annually, *forever*; but when people use multipliers of 25 or 20 or 10 or 66, instead of multipliers of 150 or 200 or 1,000 or 2,000 or eternity, they are tacitly admitting what Böhm-Bawerk put into words, to wit, they discount the future. The "unearned" income so-called is the "maturing" of future dollars into present dollars. See Böhm-Bawerk's *Capital and Interest*, Volume II, pages 259-381.

The value to *A* today of \$4,000 annually 2,000 years hence is so close to nil that no coin is small enough to designate it. For practical purposes \$4,000 as far away as 2,000 years is *valueless*. As Table I on page 271 showed, \$4,000 as far away as only 150 years is really very small (to wit, is worth \$2.65 today).

"Capitalizing the income" is then nothing more than (1) "discounting the future income" at some rate, compounded; then (2) adding the "present value" of those future incomes into per-



petuity; see Table II, page 272. When that calculation was made of the net income, of the farm discussed in the preceding issue, it became apparent that the present *value* (at 5% discount) of *all* the future \$4,000 net receipts from the farm, into perpetuity, was not "worth" more than \$80,000.

The so-called "capitalization" of income consists in placing a present value on future *shrunk* dollars. The rate that counts is the discount rate (or using the customary term, the originary interest rate) — the rate at which what is *available in the future* is discounted.

The term, *capitalizing earnings*, could not have been more inappropriately selected. People, because of the term, think they are getting the *value* of their capital back in 20 years, or whatever the figure is that they are using for "capitalization." Indeed, they get that number of dollars back, and eventually many more, but they do not get equivalent dollars (of the same value) back. The "multipliers" used to capitalize net income (say an income of \$4,000 from a farm) are computed on the basis of unshrunk dollars, whereas the very essence of reality in the situation is that the present value of the future income consists of shrunk dollars — dollars which are shrunk in proportion to the remoteness of their receipt.

For an extensive and thorough analysis of *why* people discount future receipts, see Böhm-Bawerk's CAPITAL AND INTEREST, Volume II (entitled *Positive Theory of Capital*), pages 257-273.

### **Why The Variations In The Multiplier?**

There remains the interesting practical question, *why* do the multipliers vary, such as (presently) 20 times for land, 10 times for oil company stocks, 16 times for leading food company stocks, and as much as 66 times for especially favored "growth stocks" as International Business Machines.

As the term "growth stocks" indicates, the reason why the multiplier is high does not really lie with the multiplier but with the expected increase in net yield. A *growth* stock is a stock whose earnings per share are expected to increase, but instead of estimating those increases and multiplying by a standard and invariable multiplier, the common practice is to enlarge the multiplier. That is another "illogical" but short-cut practice.

In order to portray peculiarities in the situation, a comparison

will be made of the earnings and stock prices of two conspicuous companies, Gulf Oil Corporation and International Business Machines Corporation. The earnings per share of the two companies for the latest 10 years are shown in Table I:

**TABLE I**  
**Earnings Per Share Of Two Large Companies,**  
**Gulf Oil And International Business Machines**

Year	<u>GULF OIL</u>		<u>I B M</u>	
	Per Share	Link Relatives	Per Share	Link Relatives
1950	\$1.18		\$2.01	
1951	1.49	126.3%	1.69	84.1%
1952	1.51	101.3	1.81	107.1
1953	1.86	123.2	2.06	113.8
1954	1.94	104.3	2.81	136.4
1955	2.31	119.1	3.38	120.3
1956	2.83	122.5	4.16	123.1
1957	3.54	125.1	4.90	117.8
1958	3.29	92.9	6.93	141.4
1959	2.90	88.1	7.97	115.0
Median		119.1		117.8
Avg. median (mid 3)		115.3		117.7
Arithmetic mean		111.4		117.6
Price/Earnings ratio*		10.0		66.0

\*(Oct. 1960 market price (Gulf, \$29; IBM, \$527) over 1959 Earnings)

The columns showing link-relatives need explanation. Under Gulf Oil the first link-relative is 126.3%. That was obtained by dividing \$1.49 by \$1.18; earnings in 1951 were 26.3% higher than in 1950. The second Gulf link-relative is 101.3, obtained by dividing \$1.51 by \$1.49; earnings in 1952 were 1.3% higher than in 1951. The *link-relatives* are therefore moving-base relatives; the earnings for each year are shown as a link-relative of its respective preceding year earnings. The link-relatives show the growth *from year-to-year*.

Toward the bottom of the Table, medians are shown. The median is the mid-most link-relative, in size; there are in these series four larger and four smaller link-relatives than the median. In the case of Gulf Oil, the link-relatives, ranked for size, are

126.3%, 125.1%, 123.2%, 122.5%, 119.1%, 104.3%, 101.3%, 92.9%, 88.1%. The selection of a median has the advantage of not giving weight to the extremely high and low relatives. The median link-relative for Gulf is 119.1%, and for IBM, 117.8%.

Averages (whether arithmetic means, medians or modes) are ever "dangerous," and instead of relying solely on pure medians, a modified median was also computed, namely, the average of the mid-three link-relatives; in the case of Gulf, the average is 115.3%, and includes 122.5%, 119.1% and 104.3%. Finally, a standard arithmetic mean of the link-relatives was computed. The result for Gulf was 111.4%.

The different ways of figuring affect the Gulf figures appreciably, but the IBM figures negligibly. In the case of IBM, the "growth factor" has obviously been between 17% and 18% a year.

Drawing two charts will give a good perspective of the growth record of the two companies. Chart I shows (on a logarithmic scale) the trend of the Earnings per Share of the two companies.

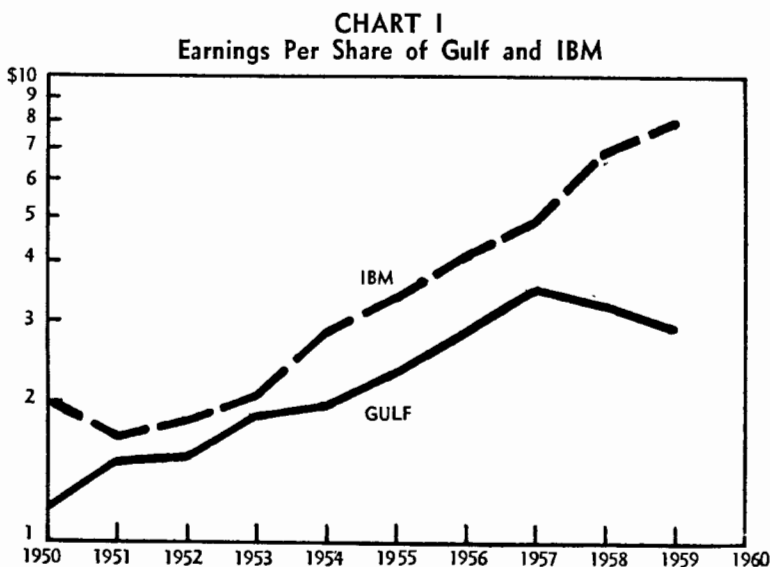
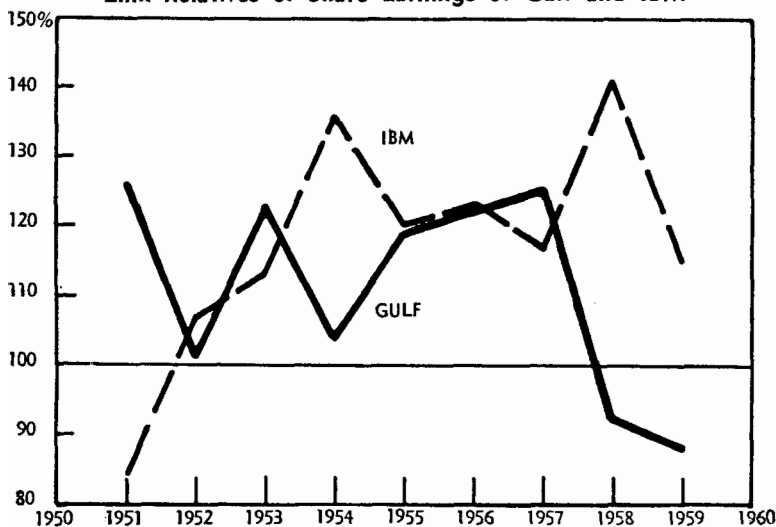


Chart I shows that the growth in the earnings of Gulf Oil has faltered in the *latest two years*. This is even more clearly shown in Chart II, which shows the link-relatives for the two companies (in this case on an arithmetic scale).

CHART 11  
Link-Relatives of Share Earnings of Gulf and IBM



The charts show that Gulf's growth fully equalled that of IBM for the first eight years of the ten years used. Failure of Gulf earnings to grow in the latest two years has undoubtedly been a major factor why Gulf sells for only 10 times earnings (compared to IBM's 66 times earnings).

It is outside the scope of this analysis to consider what the multipliers should be, and whether Gulf's multiplier is too low and IBM's too high. Those problems may be considered in a separate study.

### Conclusions

The multipliers used are "not what they seem to be," and what they are generally understood to be is logically incorrect. The manner in which people think of multipliers is illogical. But they are convenient for short-cut methods.

Further, the second illogical custom is to "vary the multipliers" in order to "take into account" the growth factor. This is an unsound practice. The logical way would be to project the net yield (in this case, the earnings per share) and influence the calculation of the proper price for the stock in that manner. To enlarge the multiplier, when it is the earnings per share which are increasing, is to reason illogically (although the conclusion may be approximately correct).

## Two Revolutions In Economic Thought

In the last half of the nineteenth century two "revolutions" in economic thought occurred, to-wit:

1. Menger's explanation that *value* is subjective and that it depends on a *demand* factor, and not a supply factor. That revolutionized economics, *temporarily*.

2. Böhm-Bawerk's explanation that the phenomenon of ordinary interest is likewise a phenomenon based on *demand*; that interest, rent and profit are not derived from a factor on the supply side such as costs, labor expended, sacrifices made, or productivity. (For example, to say that capital is productive, and that *therefore* capital must yield a "return" (in the form of interest, rent or profit) is to reason defectively.) Böhm-Bawerk's idea was as revolutionary as Menger's.

For some decades the ideas of Menger and Böhm-Bawerk took the economic world "by storm." But that surge of popularity soon lost its force, and it was not long before that popularity actually waned. Today, the ideas of Menger, Böhm-Bawerk (and their successors) are not so much unpopular; *they are not even known*. The latter is the worse of the two. For something to be unpopular requires that that something be known. But silence in regard to revolutionary ideas which are correct — a silence based on ignorance of those ideas — is a regrettable phenomenon.

\* \* \*

Businessmen do not accept the principles of Menger; they say prices are determined by costs. Neither do businessmen accept the ideas of Böhm-Bawerk; businessmen believe that profits come from productivity. As far as businessmen are concerned, Menger and Böhm-Bawerk might as well never have lived. The businessmen who fight for capitalism — for freedom of the consumer, that is, for freedom of *demand* — do not understand that the *theory* of capitalism must basically be oriented to the *demand* side, because it is *demand* that is the controlling factor.

\* \* \*

What is lamentably true of businessmen is equally true of their employees and their leaders, the union bosses. They too think that a factor of supply — labor — creates value, as the employer believes that the productivity of his machines produces value.

Socialism is founded on the idea that any value that exists is created by the embodied labor. Further, socialism says that labor is entitled to the *full value* of what it produces — which is undoubtedly correct — but socialism does not recognize that, in the terms in which it formulates its demands, it is really demanding for labor *more than it produces*. But that unreasonableness of socialism's demands is not understandable by a person, unless he first understands the effect of *time on value*, and the importance of *discounting what is available only in the future*.

\* \* \*

The understanding by investors of these problems is in no better state than that of businessmen, union leaders, or socialists. Investors do not understand what interest, rent and profits really are. They have developed certain short-cut methods for "capitalizing" income, which give reasonably "reliable" results, but the short-cut methods obscure the opportunity of fully understanding what the real logic is. In consequence, the valuations placed on capital goods in the broad sense — valuations manifested in the "capitalization" of incomes from land, capital goods and loaned money — are rather erratic, influenced by mass psychology, and often misleads the public.

\* \* \*

Men elected or appointed to government positions do not evince deeper understanding than do businessmen, employees, socialists, or investors. Bureaucrats appear to believe that the *arbitrary action* of government employees (such as members of the Federal Reserve Board, conducting themselves (perforce) according to the statute under which they operate) can annul, or at least significantly influence, a "natural law," namely the natural law consisting of the universal propensity of men to "discount the future." These devoted and well-meaning bureaucrats (whose merits consist in functioning as brakes on popular error and cupidity, but who cannot exercise a contrary, positive, correct theory of their own, and who can apply no other rule than moderation) are supposed to be able to annul, by applying a *human law*, a created, ineradicable *natural* (divine) law. Böhm-Bawerk wrote an essay, *Macht oder Economisch Gesetz*, which title can be translated, "Any Human Power versus Economic Law." Böhm-Bawerk concludes that there is no human power that can overpower economic *law*. The assign-

ment to the Federal Reserve Board, therefore, is to do what cannot be done successfully, except at the cost of eventual economic crisis, depression, and maybe earth-shaking social upheaval and catastrophe.

Then there are the moral philosophers, and the interpreters of authoritarian revelation. Moral philosophy today will not be able to progress further than the moral philosophy of ancient times, if the basis today is to be nothing more than the same naive observations that the ancients were able to make. Instead, use will have to be made of the *science* of economics.

The interpreters of authoritarian revelation will also be unlikely to make progress in many of their interpretations unless they too draw on what can be drawn from the science of economics. The interpreters of authoritarian revelation do not seem to study economics at all.

\* \* \*

Professional economists, *except those who know the German language well*, have not been adequately exposed to the "revolution" in economics, begun by Menger and Böhm-Bawerk, which revolution petered out before it could reach maturity. The profound among contemporary economists in the English-speaking world, such as Frank H. Knight, have not accepted fully the proposition, that *demand* is the *only* adequate key to value, with costs purely subsidiary; nor has a distinguished thinker as Knight apparently fully accepted that part of the thesis of Böhm-Bawerk which affirms that originary interest is really based on discounting for time. (See e.g., Knight's remarks on Fetter and Mises in his "Introduction" to the English translation of Menger's *Principles of Economics*, page 34.) Knight's interest appears to be principally in the "risk" and "uncertainty" phases of the origin of a return on capital, rather than in originary interest as a discount of the future. But he clearly sees that "capitalizing income" is a "derivative." He writes, "It is essentially the present value of a future stream of service, foreseen or expected (under ideal conditions equal to the historical cost for any item)." (Page 27 *op. cit.*) That clearly reveals his understanding that "capitalization" is the "present value" of something available in the future. But when he employs the last

two words "of service" in the expression, "stream of service," he indicates attention by him to a supply factor, *service*. The Böhm-Bawerk position must finally be reduced, as was done by Mises and Fetter, to a pure discount of the future *only*.

\* \* \*

In order for someone to arrive by thorough study to an independent conclusion of his own on the difficult and disputed questions which have been discussed, it is necessary to understand the ideas inseparably associated with Subjective Economics. To accomplish that, a requisite is to read (preferably in sequence), Menger's *Principles of Economics*, Böhm-Bawerk's *Capital and Interest*, and Mises's *Human Action*. Substitution of other works for these will probably result in inadequate understanding.

Attempt to graft Subjective Economics (that is Neoclassical Economics) onto English Classical economics is futile. The foundations are different — and irreconcilable.

The "revolution in economic thought" represented by Menger, Böhm-Bawerk and Mises needs renewed objective attention. The translations required (from the original German) have become available at last, in recent years.

What often passes for economics in this age is statistics or history or sociology — but not economics.

## Economic Justice

There are two crucial aspects of economic justice: (1) unearned income; and (2) the determination prices, including the determination (a) of the price of labor, and (b) of the price of future goods.\*

Most people would agree that (1) if the origin of "unearned income" is understood, and is realized to be in "the nature of things," and (2) if, further, the determination of prices is accomplished in a manner which protects the weaker party to the transaction, then there will be economic justice.

The several preceding issues and the earlier part of this issue

\*Items (1) and (2b) refer to the same economic phenomenon, as will be evident from the earlier parts of this issue, and the preceding issue.



have been devoted to the complex and difficult problem of the origin of "unearned income." The remainder of this issue and maybe two succeeding issues will be devoted to an explanation of the determination of prices and economic justice, which few people have endeavored to analyze thoroughly. However, moral philosophers have often been incautiously doctrinaire about economic justice, without so much as having first made even an elementary study of the economics of the determination of prices.

## Many Factors Influence Price, But One Is Chief

Böhm-Bawerk devoted 50 pages of his three-volume work, *Capital and Interest*, to an explanation of price formation (Volume II, pages 207-256). His introductory chapter to that section has the title, "Problems Confronting a Theory of Price." As an introduction to later detailed discussion, we quote extracts from this chapter.

### Problems Confronting A Theory Of Price

#### Are There Laws Of Price?

[In regard to]...*laws* of price, can there really be such a thing?

...Early economic theory did not...doubt that there was a system of laws which applied to the prices of goods, nor that it was the office of economic theory to ferret out that system of laws and to announce what it should discover in the form of the "laws of price." The fruits of the indefatigable research which it transmitted to us were "the law of supply and demand" and the "law of costs."

Later on there was a change. ...Doubts arose which shook not only the prevailing faith in the traditional laws of price, but even the belief in the existence of any system of laws at all. This skepticism gradually trickled down... until it reached the central system of the science of economics, where it has left its ineradicable marks. As is easily to be understood, the most distinct among those signs are discernible in the writings of German economists, whose enthusiasm for...[detailed research] antedated and also exceeded that of all others.

Although the flood tide of...skepticism, if I am not mistaken,\* is ebbing, I should not care to ignore completely the question it has raised. And therefore I intend...to set down in unmistakable terms my own personal confession of faith as to what our duties of commission and omission are in the field of the theory of price. The use of an analogy will make my task easier.

#### An Analogy To Show Complexity Of The Problem

If we throw a stone into the middle of the...surface

\*Present publisher's comment: Böhm-Bawerk was mistaken on this.

of a tranquil lake we see the concentric waves spread out in perfect...regularity in every direction. But if we are on the high seas we observe that the wind will blow in gusts which are perhaps approximately uniform as to velocity and direction, but never completely so. And that causes a movement of the waves which...reveals a...regular pattern but which, examined in detail, shows a multitude of minor...irregularities. And if there is then a sudden change of wind, or if the ocean swell strikes a shore line of irregularly broken cliffs there results that wild confusion and that mass of crosscurrents which is known as...surf, and which seems to have lawlessness as its only law.

If we seek the reason for this difference, we find it easily. In the first case only a single factor was responsible for the movement,... In the second case impulses of two different kinds were operative, but one was overpoweringly stronger... And finally in the third case a...mixture of mutually antagonistic causes resulted in a...mixture of...tendencies which impede and oppose each other in such a way as to destroy all semblance of regularity in the composite result.

#### Complexity Of Factors Influencing Prices

It seems to me that analogous conditions bring about analogous results in the field of price phenomena.

Our human behavior is in general the result of the influence of causative factors, and our actions with relation to exchange are no exception. Depending on whether or not one aims at being precisely specific, the number of motives operative in the making of exchanges may be two, or may be dozens and hundreds. The *two* will be egoism and altruism.

The others will include such motives as, for instance, (1) the quest of direct economic advantage, (2) the quest of indirect advantage through attraction of clientele, or (3) removal of competitors; (4) disinclination to purchase of a personal enemy, of a political opponent, of nationals of a hostile country; (5) anti-Semitism, (6) vanity, (7) vexation, (8) stubbornness, (9) vengefulness; (10) the desire to bestow on another an economic advantage out of generosity or because of personal liking; (11) the wish to punish someone, (12) to impart a lesson, etc., etc. ...

#### Oversimplification Of The Problem

... If we were always influenced in transactions involving price by a single uniform motive, for instance the motive of gaining for ourselves the maximum direct advantage in the exchange, then it would be possible at all times for the manner of functioning peculiar to that motive to develop untrammelled. And the price that became established under the exclusive influence of that motive would present an appearance no less clearly reflecting regularity and adherence to law than do the regular concentric waves set in motion by the stone thrown into the lake. And that is how economic science did, in actual fact, set up the hypothesis of selfish advantage in exchange as the sole governing motive, and thereon built the "law" of supply and demand which undertakes to predict with the precision of a mathematical formula the price that will be attained under any given relationship between demand and supply.

But the situation is in reality otherwise. We very frequently, indeed even usually, act under the simultaneous influence of several or even numerous intercrossing motives, and the character of the resulting mixture varies greatly according to the number and the kinds and even the mutual intensity of the combining motivating forces. Naturally, then, their effects also intercross, with the result that the appearance of adherence to law which may be presented by our behavior is very materially distorted. That it is not completely destroyed would appear from the fact that in that case economists would never have been led to formulate a "law of supply and demand." ...

#### Two Questions Which Must Be Answered

That is how the material is constituted, with which the price theorists have to deal. That constitution forces two questions upon our attention which must be answered at the very outset. The first is whether those cases which seem to conform only in approximate measure, or not at all to the rule, to the law, are really without rule and without law? And the second is, how can economic theory fulfill its... duty [of explanation] with respect to them?

#### Price Determination Is Not "Lawless" But Only Complicated

Let us... pattern our procedure after the physicist's. The first step he takes is to develop the *law of basic phenomenon*, that is to say of the movement of waves, presupposing a single, simple causative kinetic factor. Once he has clarified that point, he proceeds to investigate the effect produced when the activity of other influences is added to that first and simplest situation. He studies the influence exerted by... an obstacle—say a firm wall—in the course of the wave, and further subdivides by determining the effect when it strikes the wall at right angles, and when it strikes it at an acute angle. He makes a further development of the laws of "interference phenomena" which result from the collision of several waves. And here again he makes an analysis segregating the various principal types. ... Of course, the physicist's research will not provide for a separate examination of each one of all the possible causes of interference, but he will select the characteristic types in such number and with such variety as the nature of his... problem makes it seem to him expedient. ...

... Now the effects which result when many or all of the several types interact simultaneously will also cease to be a riddle. He simply analyzes what appears at first sight to be a chaos of surf, his reason breaks it down into a multiplicity of individual movements each of which is now familiar, and the manifestation of a well-known system of law. But the same physicist would certainly consider it to be as absurd as it would be hopeless, to begin by attempting at the very outset to explain all the interference phenomena without previously reducing to a rational basis both for himself and for others, the law governing the simple motion of a wave.

#### The Basic Motivation Determining Price

Now it is my belief that the price theorist has every reason to follow the same procedure. He, too, will have to

begin by developing the law of the *simple basic phenomenon*. If he cannot succeed, before all else, in discovering a rational basis for the determination of price under the influence of only a single motive, then he will certainly labor in vain for a rational understanding of the complicated phenomena resulting from the simultaneous interaction of numerous heterogeneous motives. . . .

There is an enormous difference in the scope and in the intensity of individual motives with respect to their influence on exchange transactions. One motive towers far above all others, and that one is *the quest for the attainment of a direct advantage through exchange*. And most naturally so. Exchange is a process by which one intends, for a consideration, to obtain something for himself. Hence it . . . lies in the nature of things . . . that . . . the desire to gain an advantage through exchange is almost never absent, and that in the enormous majority of cases it has the lion's share of the influence that determines our exchange transactions.

That justifies the . . . choice of those price phenomena which take place under the exclusive influence of the quest for gain through exchange, as those to be regarded as the "basic phenomenon." We may, in consequence, look upon the laws governing them as the "basic law," and regard as mere modifications of that basic law such . . . [deviations] as arise through the contributory influence of other motives. . . .

Accordingly, it seems to me expedient to divide the problem of the theory of price into two parts.

The first part concerns the necessity for developing *the law of the basic phenomenon in its purest form*. That is to say, developing the system of law which manifests itself in the phenomena of price under the presupposition that all persons participating in an exchange are actuated by the one single motive of the quest for the attainment of an immediate benefit through exchange.

The second part of the problem consists in incorporating into the basic law the modifications which result from the contributory activity of other motives and factual circumstances. . . . The typical and widely prevalent "motives" which will come in for treatment here will include such things as habit, custom, justice, benevolence, generosity, laziness, pride, national enmities, race prejudice. . . . But this second part is also the proper place for revelations concerning the function performed by institutions such as monopolies, cartels, coalitions, boycotts, governmental sales taxes, boards of arbitration, boards for the awarding of damages, labor unions and many other organizations which in modern times are fond of interposing socialization measures and a state-controlled economy as a "breakwater" to combat the force of the egoistic price waves.

#### The Contrasting English Classical and German Historical Approaches

The amount of attention devoted by economists to each of these two parts of the theory of price has varied with the prevailing phase in methods of research. As long as the abstractly deductive phase characteristic of the English [classical] school was in the ascendancy, the first part of the price problem was almost the only one to be treated, and much too nearly to the complete exclusion of the other. Later

on, the historical method, originating [with the Historical School] in Germany, took over the lead. It was characterized by a fondness for emphasizing not only the general, but the particular as well, for noting not only the influence of the broader types, but also that of national, social and individual peculiarities. During this phase there was . . . excessive zeal in according as exclusive a preponderance of attention to the second part, as the first part had previously enjoyed.

It is my intention to occupy myself with the first part of the price theory exclusively. I am going to develop the basic law of the determination of price solely on the hypothesis of the singlehanded dominance of the quest for direct advantage through exchange. In order to prevent any misunderstanding from the very outset, I wish to declare that I make no claim that I am thereby offering a complete explanation of the phenomena of price. . . . The actual price structure does not depart far from the line it would take if it were subject to the exclusive influence of subjective advantage alone. . . . That is the reason why we can go about developing that basic law which features the influence of the personal quest for advantage through exchange, knowing that in doing so we are developing that part of price theory which, of all the parts, is the most indispensable to an understanding of price phenomena. . . .

Böhm-Bawerk's point is that the "pursuit of our self-regarding interests" — what some people indiscriminately call *selfishness* — is the basic motive in exchanging, or trading, or buying and selling. Obviously, if that motivation is indeed basic, then the natural question that arises is: are not the terms on which exchanges are made usually unjust? Whatever the answer to the question, one observation may be made with assurance, namely, the phenomena of *price formation* and *justice* are inseparable.

## Equality Is An Impossible Ideal For Exchanges Between Men

People buy or sell — trade and exchange goods or services with each other — on the basis of inequality, not equality.

Inequality is, in fact, the essence of every exchange, and of the determination of every price, arrived at by negotiation (as distinguished from a price set by a bureaucrat).

The almost universal assumption or conclusion is that when two men have higgled long and with equal skill and strength, then the resulting price is such that each man receives as much as he gives. There is then a longed-for *equality* in the exchange. That idea is fallacious.

Further, the supplementary idea is, if one man is a stronger and more skillful trader than the other, that then the weaker and

less skillful trader is necessarily a loser. He has "lost" by the trade; what was the "first man's meat was the second man's poison." This is a fallacy equal to the previous one.

\* \* \*

As alternatives to the two preceding cases (fallacies), two other possibilities can be mentioned: (1) both parties lose from the transaction, or (2) both parties gain from the transaction.

The first of those alternatives is never considered seriously because, in truth, the idea is absurd. Two men will not knowingly make an exchange, both hurting themselves individually thereby. (It is possible that both make an honest error in judgment, which is human, but the idea that *the basic principle underlying free exchange is mutual loss* is too unrealistic to be treated other than contemptuously. The proposition is, in fact, never mentioned by those who discuss the general problem.)

The other possibility, that both parties to an exchange gain from the transaction, appears to most people to be optimistic as the former proposition appears to be pessimistic, that is, this proposition appears as unrealistic as the preceding one.

When the "theory of exchange," from the viewpoint of benefits and justice, is discussed by the common man — we refer to laymen in the field of economics — then it is practically unheard of that he (they) would assume *both men* would gain by the trade. That cheerful principle is apparently as unthought of as the uncheerful principle that both lose by the trade.

Aristotle taught that a proper exchange, or trade, or barter, was accomplished when there was *equality* in the transaction, for *both* parties. He was quite wrong.

Michel de Montaigne, although sophisticated enough in many other ways, taught the same fallacy.

Karl Marx made *equality* the central idea of exchange, and of the remuneration of labor. We quoted Marx (via Böhm-Bawerk) in the September issue, pages 261-263. There Marx declared that the *essence* of economic goods was the human labor incorporated in them. In the last analysis, he alleged, it was really the labor — a theoretical, abstracted, socially necessary labor — in economic goods that was being exchanged, and he alleged further that the exchange was based on equality of labor content, or that it *should* be based on equality of labor content; and finally, that if it was

not so based then there was *exploitation*. Marx's thesis was that the exchange of labor services for money wages between employee and employer, lacked equality and therefore was unjust. It lacked equality, he affirmed, because the employee was in an alleged weak bargaining position, and the employer in an alleged strong bargaining position. Furthermore, Marx argued that the amount of the exploitation was equal, for society as a whole, to what employers received in the form of ordinary interest on their enterprises. In short, Marx's case rests on an appeal for *equality* in exchange, trades, and buying and selling of goods and services. His thesis — his idea — involved, however, a patent and sad fallacy.

Moral philosophers and ethical teachers also hold forth, as their ideal, *equality* in exchange, trading, and in remuneration of labor. That ideal is taught — it is lamentable to acknowledge it — in nearly all the pulpits of Christendom. But that highly regarded source for the statements fails to give them merit. The ideal of *equality* in trades, exchanges, and remuneration does not exist, should not exist, and *should not be the ideal*. The reason for that critique of the idea of equality as being the foundation of justice is that the idea is nonsensical and quite ridiculous.

Böhm-Bawerk devoted three pages to his "Introduction" to his chapter on "The Basic Law of the Determination of Price." In those three pages he demolished the idea that *equality* is the essence of *exchanges*, *trading* or *remuneration*. We quote from Böhm-Bawerk's *Capital And Interest*, Volume II, pages 215-217.

### Exchanges Are Possible Only When There Are Inequalities In The Exchanges

#### The Three Requisites To Exchange

The decisions that have to be made in any exchange transaction always revolve about two points, namely, (a) whether in a given situation one is to make an exchange at all, and (b) in case this is decided in the affirmative, on what terms one is to attempt to conclude the exchange. Now it is quite obvious that he who transacts an exchange with the aim of attaining a direct advantage, and with no other aim, will adhere to the following rules in arriving at the decisions mentioned above: he will make an exchange only

- (1) if he can exchange to advantage;
- (2) he will exchange to greater advantage in preference to exchanging to lesser advantage;
- (3) he will, finally, exchange to lesser advantage in preference to not exchanging at all.

...these three rules are completely in the spirit of our basic motive and really constitute a translation of that motive into terms of practical behavior. But it is necessary to clarify one expression that recurs in each of them. What do we mean by "exchange to advantage"?

#### The Necessity That There Be Inequality In Exchange

Obviously that means to exchange in such a way that in the goods he receives he gains a greater benefit for his welfare than he gives up in the goods with which he parts. Or, since the importance of goods for one's welfare is expressed in their subjective value, it means that the goods he receives have greater subjective value than those with which he parts.

If A owns a horse and is to exchange it for ten barrels of wine, he can and will do so only if the ten barrels of wine offered to him have for him a greater value than his horse. Naturally the other party to the contract thinks likewise. He, for his part, is not willing to lose ten barrels of wine unless in their place he receives a good which, for him, possesses greater value. Therefore he will be willing to exchange his ten barrels of wine for A's horse only if for him the ten barrels of wine are *worth less* than the horse.

From this we derive an important rule. *An exchange is economically possible only between persons whose valuations of the good itself and of the good given in exchange differ and, indeed, differ in opposite directions.* The potential buyer must ascribe to the good a higher value; the other a lower value to what he gives in exchange. And their interest in the exchange and also the advantage they gain from the exchange increases in proportion to the disparity between their valuations; as that disparity diminishes their gain from the exchange decreases; finally, if they do not differ at all, if their valuations coincide, an exchange between them becomes an economic impossibility.

#### The Fortunate Prevalence Of Inequality Of Evaluation

It is easy to see that the prevalence of division of labor must create infinite grounds for contrasting valuations, and hence infinite opportunities for exchange. For since every producer produces only a few kinds of commodity, but produces these in a quantity far exceeding his own need, he immediately faces a superfluity of *his own* product and a shortage of every other product. Hence he will ascribe to his own product a low subjective value and to the products of others a relatively high one. The producers of those other products will however, act just the other way around, and ascribe to his product, which they lack, a high value and to their own, of which they have a superabundance, a low value. Thus there results a situation favorable for the transacting of exchanges on a large scale, in that there are reciprocally contrasting valuations.

#### The Greater The Inequality, The Greater The Capacity To Exchange

Let us pursue to its logical conclusions another idea which is implicit in the foregoing observations. We saw that an exchange is possible for an economizing individual pursuing his own advantage, only if he values the good to be acquired more highly than the good he himself possesses. It



is patent that this relation will obtain the more easily, the lower anyone values his own commodities, and the higher he values the commodities of others.

The owner of a horse for whom that horse has a subjective value of \$50, and for whom a barrel of wine has one of \$10, has a much wider possibility, economically speaking, of effecting an exchange, or as we shall hereafter phrase it, has much greater *capacity for exchange* than a man who values his own horse at \$100 and a barrel of some one else's wine at only \$5. The former can obviously still make the exchange if he is offered as little as six barrels for his horse, while the latter must forgo the exchange unless he is offered, at the least, something in excess of twenty barrels.

If a third man should value his horse at even so low a figure as \$40, and on the other hand place on a barrel of wine a value as high as \$15, he would obviously be economically capable of making an exchange if the price went down even to three barrels of wine. . . .

That gives us the general principle that *that candidate for exchange has the greatest capacity for exchange who places the lowest valuation on his own good in comparison with the goods of others which he wishes to acquire. Another way of saying the same thing is that in comparison with the good of his own with which he is to part he places the highest value on the goods of others.*

Why could not Aristotle, Montaigne, the common man (the layman in economics), and why could not Karl Marx clear away, in a few simple paragraphs their erroneous, frustrating ideas about *equality* being a requisite for exchanges, or at least for justice, in the same manner as Böhm-Bawerk has done in the foregoing?

These men blundered on this fundamental question, because they considered value to be intrinsic in a good and objective to the person. They should instead have realized that value was extrinsic to the good and subjective in the person. That difference in starting point has caused Aristotle, Montaigne, Marx and economic laymen from time immemorial to be wrong in their subsequent economic reasoning; and has enabled Böhm-Bawerk and those who follow him to be right on these issues. (In fairness to Carl Menger, it should be mentioned that the original premise, *the subjective nature of value*, stems from him and not from Böhm-Bawerk.)

The brief quotation in the foregoing sets the stage for Böhm-Bawerk's later analyses on price formation. As these are being outlined, it will be appropriate for us to analyze the "justice" of that price formation.

Böhm-Bawerk ends his introductory remarks with the following paragraph:

Having made ourselves adequately conversant with the meaning and the content of our basic motive [each man's self-regarding interest], we can now progress to our real problem. That problem is the development of the influence exerted, in accordance with regular laws, by the functioning of that basic motive on the determination of price. For this part of our problem I consider the... procedure of a few illustrious predecessors to be by far the most appropriate. They begin by demonstrating, in the case of selected typical examples, how under certain assumptions the determination of price will and must of necessity result. They then strip away such fortuitous trappings as may attach to the examples in order to leave what is typical and universally valid. That they formulate in laws.

I shall begin with the simplest typical case, with the determination of price in an isolated exchange between a single pair of candidates for exchange.

## Determination Of Price In Isolated Exchange

In order to analyze the determination of price in a simple and clarifying manner, Böhm-Bawerk considers first "Determination of Price in Isolated Exchange."

By "isolated exchange" he means *one* buyer and *one* seller (not two or more buyers and not two or more sellers). As will become apparent later, isolated exchange is the kind of transaction most susceptible of "injustice." Böhm-Bawerk writes:

Farmer *A* needs a horse, and his personal circumstances are such that his need for the horse represents an urgency of such degree that he attaches as much value to the possession of a horse as he does to the possession of \$300. He goes to his neighbor *B* who has a horse for sale. If *B*'s personal circumstances were such that he too places a value on the horse as high as on the possession of \$300, or higher, there would, as we know, be no possibility of an exchange between these two farmers. Let us therefore assume that *B* places a considerably lower value on his horse, say, a value of only \$100. What happens?

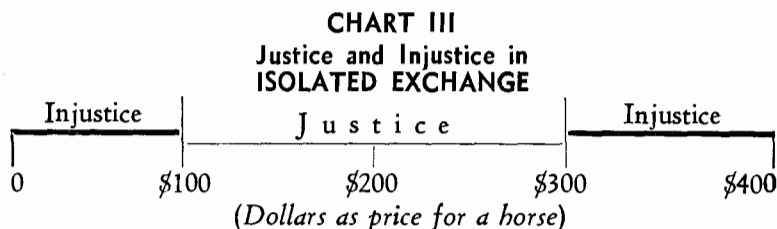
In the first place it is certain that there will be an exchange. For under the conditions as assumed, each of the parties can make a considerable gain by effecting the exchange. If they make an exchange for instance, of the horse against \$200, then *A*, for whom the horse he desires has a value of \$300 will obtain a gain having a value of \$100; *B* obtains an equal gain, since for a good that was worth only \$100 to him he now obtains \$200. In accordance with the principle "better a lesser advantage than no exchange," the two will at all events agree on the exchange at a price which is advantageous to both of them. How high will that price be?

This much at least can be said with certainty: The price will certainly have to be lower than \$300, otherwise *A* would have no economic benefit and hence no motive to effect the exchange. And the price will certainly have to be higher than \$100, otherwise the exchange would entail a loss for *B*

or at least be without benefit. But at what point between \$100 and \$300 the price will be fixed cannot be predicted with certainty. Every price between these two limits is economically possible, one of \$101 being just as much so as a price of \$299. This leaves a wide margin for bargaining. The price will be depressed or raised in the direction of the low limit or the high limit according to whether the buyer or the seller in the course of the transaction exhibits the greater cleverness, craftiness, stubbornness, persuasiveness, etc. If both parties are equally proficient in bargaining, then the price will be determined at a point somewhere in the neighborhood of the midpoint of the gap, that is to say at around \$200.

Let us briefly summarize whatever is here capable of being formulated as a law. *In an isolated exchange between two persons desiring to effect an exchange, the price will be determined within a range which has as its upper limit the buyer's subjective valuation of the good, and as its lower limit the seller's valuation.*

Let us immediately consider the aspect of potential justice. In Chart III we have drawn a line four inches long, and we have shown on that line the range in which "injustice" can occur.



If *A* and *B* are *free* (uncoerced) buyers and sellers, then they cannot suffer "injustice." But if either is a *coerced* buyer or seller, the seller will suffer injustice below \$100 or the buyer above \$300. The range of injustice is zero to \$100 for *B*; and \$300 to \$400 (or more) for *A*.

The "range of justice" is between \$101 and \$299. Some may declare that \$200 is the only really just price. We ourselves would not go so far as that. But if justice and injustice still play a role within the limits set by \$101 and \$299, then this observation should be made: so wide a range exists only in *isolated* exchange. As will be shown later, increasing the number of buyers and sellers reduces the range.

\* \* \*

It should be noted here and in what follows that Böhm-Bawerk is "down to cases," and is not discoursing in vague terms and in broad generalities.

## Determination Of Price With One-Sided Competition Among Buyers

By definition, *isolated exchange* precludes the phenomenon of competition being part of the situation.

Böhm-Bawerk next moved to one-sided competition, namely, on the buying side. Later he discusses one-sided competition on the selling side. And finally he considers the determination of price with two-sided competition on both the buying and the selling side.

What competition does to price is illuminating. Böhm-Bawerk writes about one-sided competition among buyers as follows:

Let us now modify the conditions of our example to fit the next type of case by assuming that farmer *A* who wishes to buy finds that *B*, possessor of the horse, is already being visited by *Aa* who likewise has come with the intention of acquiring the horse that *B* is offering for sale. Now *Aa* is personally so situated that the possession of the horse is, in his estimation, to be valued as the equivalent of the possession of \$200. What happens now?

Each of the two competitors wants to buy the horse, but of course only one can do so. Each of them desires to be that one. And so each will make an attempt to induce *B* to sell the horse to him. The means of doing so is to offer a higher price than does his competitor.

That brings about the familiar situation where the bidders alternately overbid each other's offers. How long will that continue? Just as long as the rising prices that are offered remain within the valuation of the competitor with the lesser capacity for exchange, who in this case is *Aa*. That is to say, as long as the bids still remain below \$200 *Aa* will be guided by the principle "rather a smaller gain than no exchange at all," and *Aa* will, up to that point, continue to raise his bids in order to win the competition for the exchange. Of course *A* will prevent that each time by raising his bid in turn. But *Aa* cannot go beyond the limit of \$200, if the exchange is not to be a losing proposition for him. In this he is guided by the principle of the gaining of advantage but couched this time as the precept "better not to exchange at all than to exchange at a loss," and at that point he throws in the sponge.

All this does not necessarily mean that the price will finally be determined at exactly \$200. It is possible that *B*, who knows how badly *A* needs a horse, will not be satisfied with \$200 and that he may succeed through stubbornness or clever bargaining in exacting from *A* some price as high as \$250 or \$280 or even \$299. The one thing that is certain is that on the one hand the price cannot exceed \$300, the value placed on the horse by the willing buyer *A*, and on the other hand cannot fall below \$200, the valuation of the competing and defeated bidder, *Aa*.

Now let us assume that in addition to *A* and *Aa* there are three more willing buyers—call them *Ab*, *Ac*, and *Ad*—

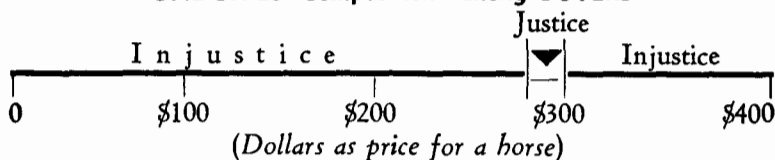
who compete for *B*'s horse. Their individual positions in life are such that they place a value on the horse amounting to \$220, \$250, and \$280 respectively. In that case it can readily be perceived that in the competitive bidding that develops *Ab* will stop bidding when the price reaches \$220, *Ac* when it goes to \$250 and *Ad* when it reaches \$280. Competitor *A*, however, will remain the one with the greatest capacity for exchange, and the price as finally determined will necessarily fall between \$300 as the upper limit, and \$280 as the lower limit, which is the value placed on the horse by the most pertinacious of the unsuccessful competitors.

Hence the results of this observation can be generalized in the following statement. *Where there is one-sided competition among willing buyers the competitor with the greatest capacity for exchange (that is, the one who values the good most highly in comparison with the consideration) will become the purchaser. And the price will fall within a range of which the upper limit is the valuation by the purchaser and the lower limit of which is the valuation by that one among the unsuccessful competitors who has greatest capacity for exchange. This holds irrespective of the second subsidiary lower limit which is always the seller's valuation.*

If we compare the foregoing statement with the typical case portrayed in... [the preceding article], it becomes apparent that the effect of competition among buyers is to restrict the range within which the finally determined price will fall; and such restriction will be toward the upper end of the range. Between *A* and *B* alone the limits of the range of possible price were \$100 and \$300; through the addition of the competing buyers the lower limit of the range was raised to \$280.

What has now happened to the "range" in which the price must fall is shown in Chart IV.

**CHART IV**  
**Justice and Injustice in**  
**ONE-SIDED Competition Among BUYERS**



By the existence of competition among buyers the range of injustice has been narrowed from \$200 to only \$20.

It is now becoming apparent how competition is a "reducer" of "injustice."

Higgling about the price for the horse will now have a relatively narrow range. The *skill* of each buyer — the *power* of each buyer — has been reduced by competition. But the *power* of the lone seller has increased.

There is hostility among uplifters and dogooders toward competition. To be opposed to competition is to be opposed to the most effective way to resist the "power" of an isolated buyer or seller.

Competition, which is no respecter of persons, is the most influential factor in the world for promoting justice.

Clearly, Böhm-Bawerk is continuing to deal with "cases" and is not losing himself in vague generalities so effectively criticized by William of Occam.

### Determination Of Price With One-Sided Competition Among Sellers

Having considered the case of one seller and five buyers, Böhm-Bawerk next turned to consideration of the case of five sellers and one buyer. It is interesting to note what happens in this case. He writes:

This case constitutes the exact counterpart to the preceding one. Entirely analogous trends lead to completely analogous results, except that the outcome is in the opposite direction.

Let us imagine farmer *A* as the only willing buyer and five owners of horses—let us call them *Ba*, *Bb*, *Bc*, *Bd*, and *Be*—each of whom, on a competitive basis, is offering to sell *A* one horse. We must further assume that the five horses are exactly equal in quality. Now *Ba*'s valuation of his own horse is \$100, *Bb*'s corresponding valuation is \$120, *Bc*'s is \$150, *Bd*'s \$200, and *Be*'s \$250. Each one of the five competitors wants to exploit the sole existing opportunity for a sale to his own advantage.

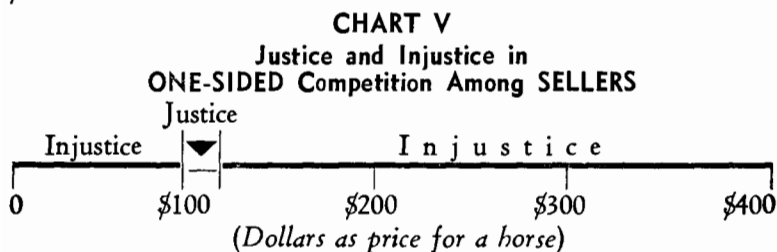
As in the previous case the means for assuring victory over one's competitors was overbidding, so in the present case it is underselling. But since no one is willing to offer his commodity for less than it is worth to himself, *Be* will stop underselling at \$250, *Bd* at \$200, *Bc* at \$150. Then *Bb* and *Ba* will continue to vie with each other until at \$120 *Bb* finds himself "economically excluded" and *Ba* holds undisputed sway. The price at which he wins through to make the sale must exceed \$100, otherwise he would gain no advantage and would therefore have no motive to make the exchange. But it cannot possibly exceed \$120, otherwise *Bb* would have continued his competitive bidding.

The case may be expressed in the following general terms. *When there is one-sided competition among sellers, it is again the competitor possessing the greatest capacity for exchange who consummates the exchange. That competitor is the one who places upon his own commodity the lowest valuation in relation to the buyer's good or medium of exchange. And the price must be determined within a range which has as its lower limit the valuation by the seller, and*

as its upper limit the corresponding valuation by the competitor having the greatest capacity for exchange within the number of the unsuccessful competitors.

In contrast to the case of the isolated exchange set forth in... [the second preceding article] where the price necessarily would be determined at some point between \$300 and \$100, in this instance the presence of competing sellers restricts the range of possible prices. And the restriction exerts its pressure downward.

Chart V shows what has happened to "justice" in this instance; this time the just price has moved far down to between \$100 and \$120.



It should now be obvious that the really significant case will be that one which involves *multi-sided* competition, the more the better — competition, not only between buyers and sellers of horses; but also of mules; of tractors; in fact of every kind of competition related to the services to be obtained from horses. That is the ideal competition.

Böhm-Bawerk next turns to the question of *two-sided* competition which still deals only with horses, but with *several* buyers and *several* sellers competing with each other. Whereas the analysis has been exceedingly simple up to this point, it hereafter becomes radically more complex, although still readily understandable.

(To be continued)

## Calvin On "The Multitude Of Counsellors"

John Calvin in one of his writings went on record in favor of a democratic form of government (as distinguished from monarchic or aristocratic). He did that on the basis of an interpretation of what Solomon says about "multitude of counsellors." Solomon wrote:

Where no wise guidance is, the people falleth; but in the multitude of counsellors there is safety (Proverbs 11:14).

If Calvin meant that the "multitude" (that is, all men or the

majority of men — which would imply a reference to *average* intelligence) has better judgment than selected, superior men, then his statement must obviously be wrong. The quality of average judgment is not something about which to boast, nor is it equal to the judgment of aristocrats.

\* \* \*

But the government of the "multitude" *may* be better than the government of aristocrats. The aristocrats, if they manage the government, may do so for the benefit of themselves, the aristocrats, and they may exploit the others.

If the "multitude" controls the government, then a factor of *majority self-interest* will come into play. The "multitude" will, at least, not favor a government which exploits the *majority*. (A monarchy or an aristocracy might conceivably exploit — often has exploited — the majority, although that is a dangerous thing for them to do.) There is a certain *safety* for the *majority*, in a democracy; in that sense, there is "wise guidance" from the "multitude of counsellors."

But that is not a question of *quality* of judgment, but of the salutary effect of the pursuit of self-interest by the majority, on the basis of the experience of its members.

\* \* \*

There is, however, no adequate protection in an ordinary democracy for minorities against majorities *unless something exists which is authorized to restrain the majority*. Mere majorities do not make a government good. In fact, few governments can, with impunity, be so tyrannical as democracies can be. And so the majority — or Calvin's "multitude of counsellors" — needs restraints. These are of two types — (1) a Constitution, or (2) the Moral Law; or as we would put it, the Law of God.

By definition, a Constitution is a traditional or established restraint on a government. A constitution is worth pricelessly more for a people's welfare than mere democracy, or majority rule. The great danger in the modern world is not from kings or aristocrats, but from the average man who abuses his democratic power, by votes and by laws, in order to oppress minorities. John C. Calhoun, greatest of American political thinkers, put it simply and powerfully in his Fort Hill address:



...the object of a constitution is to *restrain the government*, as that of laws is to *restrain individuals*.

Constitutions which are enforceable *against governments* are a good foundation on which liberty and community welfare can be built.

But a constitution is at best no better than its contents. *Its contents must agree with the moral law*, with the Decalogue, in order to be for the good of the people.

Therefore, confidence should not finally be placed in a "multitude of counsellors" — in democracy — in order to have a good government, but in a *constitution based on the Decalogue*.

\* \* \*

The Constitution of the United States was originally, in a remarkable degree, although not explicitly affirming that, based on the Moral Law. As time has passed, the trend has been to deviate from the Moral Law in legislation and in interpretation of the Constitution. The United States is therefore no longer so fortunate in its government as it was formerly. More and more, laws are being passed which give privileges to some groups among the citizenry — to the majority or to "log-rolling" minorities; the purpose of the laws should be the opposite, namely, to prevent anyone from having a legal privilege. (Reference has been made in earlier issues to two flagrant cases, *legal privileges* to labor unions and to banks.) Eventually, the "cup will run over," and the penalty will be experienced, unless there is a return to first principles.

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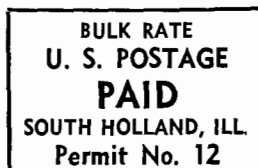
"The great art of learning is to undertake but a little at a time."

—JOHN LOCKE

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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## Determination Of Price With Two-Sided Competition

(Continued From The Preceding Issue)

### Price Formation And Justice

In a modern industrial-commercial society—that is, in a society with extensive exchanges of goods and services between individuals—exchanges are not by barter (which is a clumsy manner of exchanging), but by buying and selling. To buy and to sell, as distinguished from bartering, involves having a medium of exchange, that is, *money*. The terms of purchase and sale are consequently expressed in terms of a *price*. Prices touch the very essence of exchanges of goods and services between individuals.

A most significant question is: in an industrial-commercial society *what are the relationships between prices and justice?* If most of what a man makes is sold by him, and if most that a man needs is bought by him, and if such transactions are arranged on the basis of *price*, then *price formation* lies at the heart of *justice*. It is, consequently, singularly pertinent to analyze thoroughly the *price-formation process*.

The first and simplest analysis of price-formation, which has been made, and is truly illuminating, is that published by Eugen von Böhm-Bawerk in Volume II of his *Capital and Interest*, pages 207 to 256.

In the previous issue (October), the first three of Böhm-Bawerk's four analyses were reproduced, namely, price-formation (1) in isolated exchange, (2) with one-sided competition among buyers, and (3) with one-sided competition among sellers.

But the mass of exchanges (purchases, sales, payments) are not under one of these three conditions, but instead are under "two-sided competition," that is, the exchanges take place under circumstances involving several buyers, competing with each other to buy; and several sellers, competing with each other to sell. *Reality* in price-formation in the modern world is represented by two-sided competition in exchanges of goods and serv-

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ices. (In addition, there is a still broader and more important competition, namely, *multi-sided competition*, that is, *competition between different products*. Such competition is not being discussed in this issue.)

\* \* \*

Böhm-Bawerk, as in the earlier cases, is using in his analysis of two-sided competition the buying and selling of horses. In regard to two-sided competition he writes:

**Bohm-Bawerk's Eight Sellers Of Horses And Ten Buyers**

The case of two-sided competition is both the most frequent occurrence in practical life and also the most important for the development of the law of price. We must therefore devote to it the most thorough attention.

The typical situation which this sort of case presupposes can be represented by Table I. That table conveys the picture of ten willing buyers and eight willing sellers each of whom wishes to buy or to sell, as the case may be, one horse. At the same time the table indicates the degree of subjective valuation applying to each of the candidates for exchange with respect to the commodity in question. The irregularity of the variation of the figures for those valuations is quite in keeping with the actualities of economic life. In actual fact the individual conditions of supply and demand which determine subjective value vary so widely that it is hardly possible that any two persons place exactly the same subjective value on any one thing.

The table is as follows:

**TABLE I**  
**Buyers And Sellers Of Horses In Two-Sided Competition**

Ten Willing Buyers		Eight Willing Sellers	
Designation	Each Man's Valuation Of One Horse	Designation	Each Man's Valuation Of His Horse
Aa	\$300	Ba	\$100
Ab	280	Bb	110
Ac	260	Bc	150
Ad	240	Bd	170
Ae	220	Be	200
Af	210	Bf	215
Ag	200	Bg	250
Ah	180	Bh	260
Aj	170		
Ak	150		

It is necessary to add to the foregoing description of the situation that all parties are present in the same market at the same time, that all the horses offered are

equal in quality, and finally, that all the candidates for exchange are free from any misconception regarding the market situation which could prevent them from effectively pursuing their own interest. Once more we ask, "What happens in this situation?"

The reader's awareness of the difficulties and his pleasure in solving the problem, will be enhanced if he takes pencil and paper, and sets himself the task of solving the problem by his own method.

# **1. BAFFLING AND CONTRADICTIONARY RESULTS FROM VARIOUS COMBINATIONS OF PAIRS OF BUYERS AND SELLERS**

His first inclination will be to make a quick effort to "match" buyers and sellers, and provide a snap answer.

When he examines the data in Table I, he soon realizes that he can "match" several ways:

- (1) High-price buyers matched to low-price sellers. (In this case, he works down the two columns, pair by pair.)
- (2) Low-price buyers matched with low-price sellers. (In this case, he works up the buyer column and down the seller column.)
- (3) High-price buyers matched with high-price sellers. (In this case, he works down the buyer column and up the seller column); and
- (4) Low-price buyers matched with high-price sellers. (In this case, he works up the two columns, pair by pair.)

## **Matching High-Price Buyers With Low-Price Sellers. Method No. 1**

The way the buyers and sellers are listed in Table I makes it natural to begin by trying to match buyers and sellers simply by working down both columns; that is the way we read, and so we endeavor to solve as we read.

Buyers and sellers are listed with high-price buyers first and low-price sellers first. *Aa* is the first buyer listed, a buyer willing to pay \$300 for a horse; *Ba* is the first seller listed, a seller willing to sell for \$100. And so on down the columns.

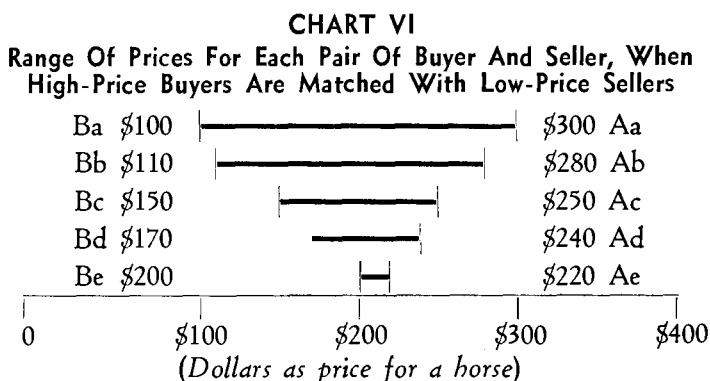
When the reader comes to buyer *Ae* willing to buy at \$220, and to seller *Be* willing to sell at \$200, he realizes that these two can make a deal between \$200 and \$220.

From that point on, it appears no more exchanges can take place, because the sellers want more than the remaining buyers

are willing to pay. On that basis, five horses will be sold, and no more.

And what will the price be? The first question to consider in that connection is whether these horses, all equal, are to sell at the same price, or different prices. Should *Aa* pay \$300 and *Ae* \$220? Should *Ba* sell for \$100 and should *Be* get \$200? Or should the price be *equal* for all buyers and sellers? There are, then, three questions: (1) who is to be included in the deals, (2) should the price be equal, and (3) what should the price or prices be?

Chart VI shows the possible "range" of prices for each pair of buyer and seller.



Under this matching system there can be five different prices. The market will be chaotic.

The first pair can "horse-trade" between \$100 and \$300; the fifth pair can "horse-trade" in a much narrower range, between \$200 and \$220.

Obviously, if there is to be uniformity of price, on the ground that uniformity of price is a requirement for justice, then the foregoing way of matching buyers and sellers is inappropriate, and will have to be abandoned.

Further, this system "isolates" each pair, and lets the bargaining strength of each buyer and each seller, *uninhibited by competition*, have free rein within the limits set by their respective subjective valuations. This is really not a *market*, but purely isolated trading.

A conclusion may be reached: Method No. 1 is not desirable.

(Note: Other combinations of pairs, affecting details somewhat, can be arranged in this and in the following cases as well. But these variations were not considered worthy of the space required.)

**Matching Low-Price Buyers With  
Low-Price Sellers. Method No. 2.**

In this case, we work up the original data in the buyer column and down in the seller column, in Table I. So that we can conveniently work down both columns again, we rearrange the data appearing in Table I to get Table II; the buyer column is inverted.

**TABLE II**  
**Buyers and Sellers of Horses in Two-Sided Competition**

Ten Willing Buyers		Eight Willing Sellers	
Designation	Each Man's Valuation Of One Horse	Designation	Each Man's Valuation Of His Horse
Ak	\$150	Ba	\$100
Aj	170	Bb	110
Ah	180	Bc	150
Ag	200	Bd	170
Af	210	Be	200
Ae	220	Bf	215
Ad	240		
Ac	260	Bg	250
Ab	280	Bh	260
Aa	300		

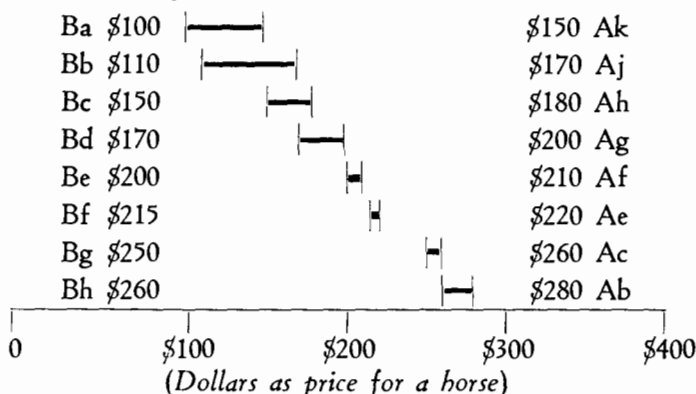
In this case, all eight horses can be sold. There can in this case be eight different prices, depending on the skill of the eight sets of traders. Chart VII shows the situation in this case, in a manner parallel to the situation shown in Chart VI.

This case has an added peculiarity, to wit, two buyers who were willing to pay much, *Aa* willing to pay \$300, and *Ad*, \$240, are both excluded. (However, the pairing could be different; instead of excluding the high-price buyers, the pairing could have excluded two of the low-price buyers.)

Justice? How can the sellers have had justice when the

CHART VII

Range Of Prices For Each Pair Of Buyer and Seller, When  
Low-Price Buyers Are Matched With Low-Price Sellers



best and fourth-best buyers, ready and willing and able to pay \$300 and \$240 respectively, were excluded?

Method No. 2 must be adjudged inadequate and unacceptable.

#### Matching High-Price Buyers With High-Price Sellers. Method No. 3.

In this case, again for easy analysis, we arrange the figures, originally shown in Table I, by reversing the seller column and beginning with the high-price sellers. This gives us Table III.

TABLE III  
Buyers And Sellers Of Horses In Two-Sided Competition

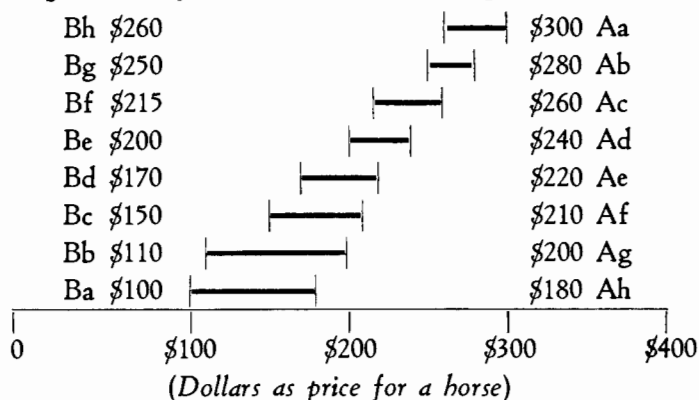
Ten Willing Buyers		Eight Willing Sellers	
Designation	Each Man's Valuation Of One Horse	Designation	Each Man's Valuation Of His Horse
Aa	\$300	Bh	\$260
Ab	280	Bg	250
Ac	260	Bf	215
Ad	240	Be	200
Ae	220	Bd	170
Af	210	Bc	150
Ag	200	Bb	110
Ah	180	Ba	100
Aj	170		
Ak	150		



It is quickly obvious that when this system of pairing is employed all eight horses will be sold. The only buyers left are *Aj* and *Ak*, who were willing to pay \$170 and \$150 respectively for a horse. There were, in fact, two sellers who would have been willing to sell for \$100 and \$110 respectively, but they were able to get more than \$170 from the buyers with whom they were paired.

Chart VIII shows the range of prices for the eight trades.

**CHART VIII**  
Range Of Prices For Each Pair Of Buyer and Seller, When  
High-Price Buyers Are Matched With High-Price Sellers



Again, this is not a *market*, but a number of isolated sales. Each pair is uninfluenced by other buyers or sellers. The pairs are, as it were, in water-tight compartments. Almost surely, the eight horses, of equal quality, will nevertheless have eight different prices, determined by the pairing and the trading skills of the men in each pair.

#### Matching Low-Price Buyers With High-Price Sellers. Method No. 4

In this case, the figures in both columns in Table I are reversed, and we get Table IV, as follows.

Four horses will be sold. Excluded buyers will be *Ab*, willing to buy at \$280; and *Aa*, willing to buy at \$300; the excluded sellers will be *Be*, *Bf*, *Bg* and *Bh*.

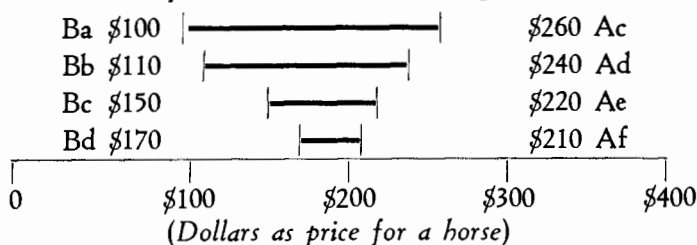
Graphically, the situation is portrayed in Chart IX.

**TABLE IV**  
**Buyers And Sellers Of Horses In Two-Sided Competition**

Ten Willing Buyers		Eight Willing Sellers	
Designation	Each Man's Valuation Of One Horse	Designation	Each Man's Valuation Of His Horse
Ak	\$150	Bh	\$260
Aj	170	Bg	250
Ah	180	Bf	215
Ag	200	Be	200
Af	210	Bd	170
Ae	220	Bc	150
Ad	240	Bb	110
Ac	260	Ba	100
Ab	280		
Aa	300		

**CHART IX**

Range Of Prices For Each Pair Of Buyer And Seller, When  
 Low-Price Buyers Are Matched With High-Price Sellers



The remarks made in the preceding cases, apply one way or another here, too.

#### Conclusions, From Foregoing Attempted Quick Solutions

It is apparent from the foregoing that the solutions attempted are invalidated by eager and superficial over-simplification. Individual pairs of buyers and sellers are matched *arbitrarily* just to get a quick answer. But by that process the answers can be so varied that they are worthless.

In the foregoing, *four* patterns of solutions were attempted; we began with high and high, or low and low pairs, etc., but what was to prevent us from selecting *any* pair on a different

basis? Nothing. Answers that might be obtained are as numerous as the permutations mathematically possible.

The deficiency consists in that a solution has been attempted without assuming a *market*. A market at least requires that buyers begin by underbidding and finally bid what they are willing to pay, and that sellers begin by over-asking and finally ask what they are willing to sell for. They *compete* with each other.

The existence of a *market* assumes in addition to the foregoing that *each* buyer endeavors to play his need off against *all* sellers, and that *each* seller endeavors to play off his wish to sell against *all* buyers. Every man in the situation is motivated by his own peculiar motivations, by the "pursuit of his self-regarding interests." His basis is his own individual *subjective* evaluation. Those valuations differ more or less for every person. (*Selfishness*, correctly understood, must motivate every seller, more or less, otherwise he would *give* his horse away and not bring it to market.)

Each man begins by disclosing a little of his subjective evaluation. As the bidding and asking proceeds, each man is compelled to reveal, to all the others, more and more what his evaluation is. The market, however, does not reveal *everything* about the evaluations of the buyers and sellers.

The "struggle" of the participants in the market is to *find one single price for all*. Probably most people would agree that that is "justice." If that is not justice, then the question is: what is justice *otherwise*? a *varied* price? and *how* should it be determined?

\* \* \*

It is desirable to imagine a horse market, an acre of ground with an ample number of hitching posts. To this place the men who have horses to sell bring their horses and hitch them to a post they select. To this place, too, come the buyers. Further, there will be spectators, people who are curious; horse grooms who want a fee to curry the horses; veterinarians who may be consulted; money lenders who may be prepared to help a buyer who lacks the necessary ready cash; and others.

In actual fact, every horse will be different in age, height, weight, build, color, etc. The prices arrived at will attempt to allow for all those differences. But in order to keep the prob-

lem as simple as possible, in this imaginary horse market, all the horses are assumed to be identical. After the buyers have looked all the horses over, they say to themselves: there is no difference in *these* horses; they are all alike.

From this point on a description of what happens in order to determine the market price for horses is left to Böhm-Bawerk (see his *Capital and Interest*, Volume II, page 221ff.). We quote in part and with minor variations. (When checking from text to Table, see the original Böhm-Bawerk table on page 323, labelled Table I.)

## II. BOHM-BAWERK'S ANALYSIS

Wise Buyers Exercise Restraint And Do Not  
Reveal Their Real Positions Immediately

*Aa*, whose individual circumstances cause him to value a horse at \$300, would consider it to his advantage to buy even at a price of \$290, and each of the eight sellers would certainly be most eager to sell his horse to *Aa* at such an advantageous figure. But obviously *Aa* would be acting most unwisely if he were to buy prematurely at so dear a price. For his interest demands not merely that he gain an advantage—any advantage at all—but that he gain a maximum advantage through the exchange. To that end he refrains from precipitately making the highest offer to which he could at the worst agree. He will prefer, instead, to begin with just as low offers as do his competitors of lesser capacity for exchange, and he will consent to raise his offer only at such time and to such extent as becomes necessary to prevent his exclusion from the exchange.

Similarly, *Ba* could, economically speaking, very well sell his horse for \$110 and could very easily find buyers at that price. But he will carefully hold back from agreeing to the lowest offer that he *could* possibly accept, and will make his offer to sell only just low enough to remain in the competition at all for the sale.

The transaction will therefore presumably begin with restraint, the willing buyers, on the one hand, offering low prices and the willing sellers, on the other hand, exhibiting the same restraint by demanding high prices.

Let us assume the buyers begin with an offer at a price of \$130. It is clear that in the absence of some gross error in the understanding of market conditions no sale will be concluded at that price. For all ten buyers place the value of a horse at over \$130 and all ten would be willing to buy, while only two horses could, economically speaking, be offered at that price—the horses owned by *Ba* and *Bb*. It is clear these two sellers would be acting just as unwisely by failing to utilize for themselves the competition among the buyers to bring about a raising of the sale price, as would the buyers if they allowed the most advantageous purchase opportunities to be snatched

away by two of their number without making an attempt to gain an advantage for themselves by offering a price somewhat higher, but still very advantageous. Hence, just as in the case described on page 315, there will have to be a sifting out of some of the large number of buyers through attempts on their own part to outbid each other. How long will that keep up?

At \$150 all ten buyers can still remain in the bidding. From that point on the competitors with the least capacity for exchange must drop out, one after the other. At \$150 *Ak* is forced to drop out, *Aj* likewise at \$170, *Ah* at \$180, *Ag* at \$200.

But at the same time, as prices rise there is an increase in the number of sellers for whom participation in the exchange becomes an economic possibility. From \$150 up *Bc* can give serious thought to the matter of making a sale, at \$170 *Bd* can do so, and at \$200 *Be* can, too.

Thus gradually there begins a shrinkage in the discrepancy, which at first yawned so widely, between the number of horses desired and the number effectively offered for sale. At \$130 there was an effective demand for *ten* horses and only *two* could have been economically offered for sale. Now, at a price of more than \$200, there is an effective demand for only *six* horses and there are already *five* that can be offered for sale. The number of willing buyers exceeds by only one the number of competitors able to sell.

#### Purchases And Sales Must Be An Even Number

Nevertheless, as long as the number of those desiring to buy is in excess at all, and this aspect of the market condition is correctly perceived by all parties, the business cannot be consummated.

For one thing, the sellers still have the possibility of exploiting the excess in number of competing buyers to increase the price still more, and they have the inducement to do so.

For another thing, the conflicting interests of the buyers compel them to continue to outbid each other. For *Af* would be making a poor defense of his interests if he supinely submitted to the action of his five competitors in buying the five most cheaply offered horses "from under his nose." For in that case *Af* would have absolutely no chance at all to make an exchange and hence to gain an advantage through such exchange.

At the same time none of *Af*'s competitors can permit him to acquire one of the five highest priced horses offered for sale. For if that happens, then the one who withdraws in *Af*'s favor, though he could still, to be sure, buy the horse he needs, would then have to get it from among the remaining less favorable exchange possibilities, the ones that are offered by the more stubborn sellers *Bf*, *Bg* and *Bh*, and then, too, at a price which *at the least* exceeds the subjective valuation that *Bf* places on his horse and hence exceeds \$215.

Thus the realization of their advantage impels all the buyers to continue to outbid each other above the \$200 mark.

An important change in the situation takes place when the rising offers each the \$210 mark. Now *Af* is forced to drop out of the number constituting the "demand" and there are now only five making a demand aligned opposite five willing sellers. Since all the former five can be simultaneously satisfied, there is no longer any reason for them to drive each other out of the market by raising their bids. On the contrary, it is to their common interest, as against the sellers, to close their transactions at the lowest possible price. Hence the outbidding by the buyers which up to this time prevented a purchase being closed, now comes to an end, and *it is possible* to close at a price of \$210.

#### The Second Phase Of The Higgling On The Price

But it does not follow that the closing *must* be at that price. It is possible that the sellers can be stubborn and that, hoping for still higher prices they refuse an offer of \$210. What happens in that case? At first the willing buyers, in order not to fail finally to accomplish their purpose, will continue to bid. But they are getting close to their limit. For if the price demands of the sellers should exceed \$220, then *Ae* would also have to forgo making a purchase and there would then be five willing sellers aligned opposite four willing buyers. In that case one of the sellers would have to drop out. And since nobody wants to be the one to do the dropping out, motives will function that are similar to those that actuated the overbidding by the buyers when they were in the majority. Except that now there will be alternate *underbidding* by the sellers, who in number exceed the buyers until the fifth seller has found a buyer. And he finds him below the \$220 mark.

In fact, in our concrete example the price limit would have to be somewhat lower still. For as long as it were a question of a price exceeding \$215, a sixth possible seller would arise in the person of *Bf*. His joining the ranks would put the sellers in the majority as against the five buyers and that would impose on those six sellers the necessity of taking measures to avoid being excluded from the exchange. And those measures would consist in underbidding each other. Not until the weakest party to this competition meets defeat is the issue settled. And that defeat is the portion of *Bf* in the moment when the price demands of the competing sellers go below \$215. At that moment the number of competitors in the group of sellers becomes equal to the number in the group of buyers, and that price is attained which constitutes the only one at which competition ceases.

Hence we find in our example, (which pre-supposes economic behavior of all competitors and correct perception by them of the condition of the market) that the zone within which the price must of necessity be determined, lies between the limits of \$210 and \$215. For only within that zone do we have the only situation that meets the two conditions necessary to completion of the transaction. Firstly, all the parties who are still in a position to "talk business" can at that price gain an advantage. Secondly, all those who cannot at that price gain an advantage, that is to say, the excluded competitors, have no power to interfere in the business of the others.

What has Böhm-Bawerk accomplished by this analysis?

To answer that it is necessary to realize that he had two requirements or objectives in mind: (1) to obtain *one* price, and (2) to have an *even number* of buyers and sellers (purchases and sales). These two objectives go together, but number one is—must be—*antecedent* to number two.

In the wrong manner attempted earlier in this article, we began by pairing, regardless of a *single* price being obtained; contrarily, Böhm-Bawerk from the beginning consistently has kept in mind, in his calculation, that one market price was the goal of the higgling.

His second step was to solve his problem further, after he had six willing buyers and five willing sellers. He had to determine whether he could find a willing sixth seller. In any event, he had to have a pair. He was unable to find a sixth willing seller, and so there were finally only five pairs.

His final step was to bring down the upper range of the price as far as the last excluded would-be seller was willing to go (from \$220 to \$215).

*That* was his systematic method.

Let us cull from this long presentation of the facts those fruits which offer nourishment for our theory of price. We may deduce answers of broad validity to four questions. Two propositions concern the persons of the groups effecting an exchange, two concern the price at which the exchange is made.

#### Question And Answer No. 1

*Our first question reads: "Among the competitors seeking to exchange, which ones actually succeed in doing so?"* Our example gives us a completely precise answer; it is: *The competitors in both groups possessing the greatest capacity for exchange.* That is to say, it is the willing purchasers who place the highest value on the commodity (*Aa* to *Ae*) and the willing sellers who place the lowest value on it (*Ba* to *Be*).

#### Question And Answer No. 2

*The second question is: "How many competitors on either side consummate an exchange?"* The answering of that question is important, inasmuch as the definitiveness of the price laws we intend to set up must, as we shall soon see, depend on that answer. Let us begin by looking once more at our example. Five pairs effect an exchange. If we observe closely, we note that they are the same five pairs who, regarded individually, meet the economic requirements necessary to an exchange. That is to say, it is true of both members of each pair that each of them, as a contracting party, places a higher value on what he is to re-

ceive than he does on that with which he is to part. All those pairs of whom that cannot be said are excluded from accomplishing an exchange.

It is easy to convince ourselves that this is no mere fortuitous result, but rather a result based on inner necessity. There are two ways of so convincing ourselves—we can either multiply the number of concrete instances, or we can examine in detail the process by which the result came about. And in the course of doing so we shall also become convinced that the number of pairs is limited to such a number as we find meeting the required conditions when we pair them off in descending order of their capacity for exchange, first pairing together those with the greatest such capacity, next those with the second greatest such capacity, and so on.

We may therefore formulate the general rule as follows: The number of competitors of each class—buyers and sellers—who actually effect an exchange may be determined by pairing off the competitors in descending order of capacity for exchange. The number of pairs making an exchange will then be equal to the number of pairs in which, in terms of quantity of the medium of exchange, the willing buyer places a higher valuation on the commodity than does the seller.

Böhm-Bawerk in the foregoing reveals another feature of his method of solution, namely, he aimed his search for the selection of pairs to those with the greatest capability of exchange, that is, he arranged his pairs according to the listings in Table I (and not as in Tables II to IV, in which we “experimented”).

The third and fourth questions concern price directly.

#### Question And Answer No. 3

The *third* imposes the requirement that we establish that all exchanges effected under the influence of competition at any one given time are all consummated at an *approximately uniform price*. We did that in our example where we demonstrated that all five pairs would negotiate their exchanges at prices falling within the limits of \$210 and \$215.

#### Question And Answer No. 4

The most important question is the *fourth*, namely, “*At exactly what price is this uniform or ‘market price’ established?*”

In no event may it be in excess of the valuation by *Ae*, and in no event inferior to the valuation by *Be*. For otherwise the price would have been so high, on the one hand, that the fifth buyer would have been excluded, or it would have been so low, on the other hand, as to exclude the fifth seller. And with either one excluded, no equilibrium would have been established.

But it is also true that the price could in no event be higher than the valuation by *Bf*, nor lower than that by *Af*. For otherwise there would have been an addition, on the one hand, of a sixth bidder to the ranks of the willing buyers, or on the other hand, of a sixth competitor to the ranks of



the willing sellers. And again the equilibrium would have been destroyed and there would have been no escape from a continuation of the over- and under-bidding until the price had been forced within the limits already noted.

Let us couch that conclusion in general terms.

*Where there is two-sided competition the market price will become established at a point within a range having an upper and a lower limit.*

*The upper limit is determined by the valuation by the last buyer to come to terms and the valuation by that excluded willing seller who has the greatest capacity for exchange.*

*The lower limit is determined by the valuation by the last seller among those to come to terms, and the valuation by that excluded willing buyer who has the greatest capacity for exchange.*

The determination of the limit by two valuations must be interpreted to mean that that valuation will prevail which in each instance makes narrower the range within which the price must fall.

Now in the above formulation let us discard the cumbersome and detailed description of the four persons described as the determining factors and employ the short and descriptive term of "marginal pairs." Then we arrive at the following most simple formulation of the law of price. *Market price is established at a point within a range which is limited and determined by the valuations by the two marginal pairs.*

The result thus attained leads to a number of speculations which become significant for the total concept we must formulate of the process by which price is determined.

#### Price Is Determined By Subjective Valuations

Pre-eminent among the objects of such speculation is the striking analogy between the determination of price and the determination of subjective value. The subjective value of a good is set up as a "marginal value" and is determined by the final utility which is situated at the very limit or margin of the economically permissible. And this is true quite irrespective of the more important uses to which certain individual examples of the total supply of the good may be devoted. In the same way every market price is a "marginal price" and is limited by the economic condition of those competing pairs who are situated at the very limit or margin of the "capacity for exchanging."

Furthermore, it will be readily perceived that this analogy is not the caprice of coincidence, but rather a manifestation that related underlying causes in both cases bring about related results. In the case of subjective valuation the motive of economic advantage imposed the requirement that the available supply of a good must be utilized to satisfy wants in the descending order of their importance, whereby some particular want is satisfied last and thus designates the "marginal utility."

In the case of determination of price the motive of economic advantage of the participants imposes the requirement that the pairs of contracting parties having the

greatest capacity for exchange shall consummate exchanges in descending order of such capacity. The progression must reach one last pair which thus becomes the "marginal pair."

In the former case there was assurance of the satisfaction of all wants surpassing the marginal utility in importance, even without the specimen which was being evaluated; and the only utility dependent on that specimen was the final or marginal utility.

In the latter case there is consummation of exchange, even at higher or lower prices, on the part of all pairs surpassing the marginal pair in capacity for exchange; and the only pair whose fate is dependent on that exact price—neither higher nor lower—is the final or marginal pair.

And finally, just as in the former case it is the importance of the last dependent want which, by virtue of this relationship of dependence, assigns to the good its value, just so in the latter case is it the economic circumstances applying to the last pair of contracting parties which assign a price to the good being exchanged—and again this takes place by virtue of that same relationship of dependence.

But the foregoing analogy by no means exhausts the relations between price and subjective value. It is of greater significance that *price is, from beginning to end, the product of subjective valuations*. Let us retrace our mental steps. It is the relation between the subjective valuations placed upon the good and its medium of exchange which determines who can entertain any idea at all of entering the competition to exchange the one for the other—that is to say, it determines who possesses "capacity for exchange."

That same relation determines the degree to which each competitor possesses that capacity. For each one of them it establishes with inexorable exactitude the point up to which his economic advantage demands that he continue to compete and just as exactly the barrier which forces him to concede defeat and to withdraw to the ranks of those whom his competitors have outbid and thus excluded.

In further consequence, that relation determines who among all the competitors possessing the "greatest capacity for exchange" shall really consummate an exchange; it determines who shall occupy the position of marginal pair, and hence it ultimately determines how high shall be the price at which the actual exchange takes place on the market.

Hence we may say that throughout the entire pricing process—insofar as it takes place on the basis of purely self-regarding motivations—there is not a single phase, not a single feature which could not be traced back to subjective valuations as the underlying cause and, basically, it is entirely natural that that should be so. For we know that our subjective valuations indicate to what extent, if at all, our well-being depends on a given good; hence they are the natural, if not indeed the only possible guide for our actions whenever we acquire or relinquish goods solely in the interest of our well-being.

We are therefore fully entitled to describe price as *the effect that results in the market from the reciprocal impact of subjective valuations of goods and of their media of exchange*. [That media is either money or other goods.]

#### Excluded Competitors Do Not Influence Price, Except The Marginal Excluded Pair

It is, to be sure, a resultant of a peculiar kind. The measure of price does not derive merely from the sum or from the average of all the valuations that are made. These exert quite a variety of influences on the determination of the resultant price. A certain portion of them, namely the valuations of the excluded competitors, exert no influence at all, with the single exception of that excluded pair which possesses the greatest capacity for exchange. As to all the rest, it would make no difference if ten times as many of them were represented in the market, the result would not be changed one iota.

In our own example the excluded competitors *Ag, Ah, Aj, Ak* might be present in the market or not; the category of those "excluded" might be represented by those four or by hundreds of additional competitors, all of them not in the position to bid more than \$200 for a horse. In any case the resultant price will inevitably be determined, as before, at a point between \$210 and \$215, as can easily be demonstrated. The excluded competitors can swell the market crowd but they are not a factor in the market situation which governs the determination of price.

#### The Neutralizing Effect Of Non-Marginal Buyers And Sellers

There is a second group which plays a very peculiar role, and that is the group of valuations made by all the pairs of contracting parties actually consummating an exchange, excepting the final pair. The effective influence exerted by that group of valuations consists entirely in the fact that they check and neutralize each other. Let us look once more at our typical example. If we seek to determine what contribution the presence of *Aa*, let us say, makes to the determination of price, we discover that it serves to offset one member of the opposing group, such as *Ba*; and it does this so effectively that the pricing process goes on in exactly the same way as if *Aa* and *Ba* were not present in the market at all.

Similarly, one can easily convince oneself that the effectiveness of *Ab, Ac* and *Ad* consists solely in that they cancel the effectiveness of the opposing *Bb, Bc* and *Bd*. With all of them present in the market the resulting price is determined at a point between \$210 and \$215; if all of them together were absent from the market, then *Ae* and *Be* would effect an exchange between them at a price between \$210 and \$215.

At the same time it should be pointed out and emphasized that, as far as this result is concerned, *the degree of the subjective valuations* which belong to this group is a matter of complete indifference. For instance *Aa* in our table makes a valuation which we placed at \$300; but he would be no more and no less of an offset for *Ba* if that figure amounted to only \$250 or even \$220. And, on the other hand, even if the figure were \$2,000 or \$20,000 this fantastically high valua-

tion would not benefit the resulting price at all. Its entire effectiveness would still be completely absorbed in its neutralization of *Ba*.

But even though we deny to the valuations by this group *any direct influence* on the determination of the resulting price, it can nevertheless by no means be maintained that they exert no influence whatever. For the valuations that belong to this group — in our table they are those by *Aa*, *Ab*, *Ac*, and *Ad* — by neutralizing the valuations by an equal number of the opposing group — our *Ba*, *Bb*, *Bc*, *Bd* — serve a double purpose.

In the first place they prevent a stronger competitor than *Be* among the sellers from acquiring membership in the marginal pair which does directly determine price.

And in the second place, they prevent a situation in which the strongest competitors among the sellers, being themselves no longer offset, can move along to neutralize the next strongest competing buyers and so bring it about that instead of *Ae* some still weaker member of the group of buyers acquire membership in the determinative marginal pair.

We can therefore most accurately formulate the role played by all those exchanging pairs whose capacity for exchange exceeds that possessed by the marginal pair. And we can do so in the following words. *They do not, by their valuations, exert any direct influence on the determination of the resulting price; but they do exert an indirect influence insofar as, by their reciprocal neutralization, they reserve the position of marginal pair to some other definite pair.*

#### The Crucial, Price-Determining Pairs

There is, finally, a third and very small group of valuations which play a conclusive and deciding role in the determination of price. That group comprises the valuations of the marginal pair. They and they alone are the component forces the resolution of which exercises the directly effective influence which results in a market price of a definite magnitude.

All weaker competitors attempting to effect an exchange, be it remembered, are *ipso facto* without influence on price; all stronger competitors neutralize each other; only the marginal pairs remain.

At first glance it may well appear to be strange that so few persons, and particularly persons so lacking in prominence, should be able to swing the decision which governs the fate of the whole market.

But a closer examination of the situation will reveal this to be perfectly natural. For if all are to make an exchange at *one and the same* market price, then that price must be so set as to suit *all* persons who make the exchange. Now every price which suits the contracting parties possessing the least capacity for exchange, must naturally suit all persons with greater capacity for exchange in correspondingly greater degree.

But we cannot add to that statement "and vice versa!" And for that reason the economic situations of the *last pair* to whom the price must be acceptable or of the *first pair* to whom it must be unacceptable, must necessarily set the measure of price.

This furnishes us with the premise of a remarkable conclusion. For it is by no means ineluctably necessary that every disturbance in the reciprocal relation of both exchanging parties (or in what so many like to call "the relation between supply and demand") bring with it a disturbance of the market price. Quite on the contrary, all those changes are without effect which fail to disturb the situation of the marginal pairs. For they alone are determinant.

Let us state that in greater detail. Any increase or decrease in the number of *excluded competitors* is irrelevant; every increase or decrease in the *intensity of valuation on the part of those persons* is likewise irrelevant, provided it is not of such magnitude that they cease to be "excluded" competitors.

And, finally, every increase or decrease, (even a unilateral one), in the *intensity of the valuations on the part of competitors actually effecting an exchange* — except for the marginal pair — is also irrelevant provided only that such persons are not thereby removed from the ranks of effective buyers and sellers.

Only two kinds of change are really significant. One is a change in the valuations on the part of those persons who comprise the *marginal pairs*; the other is a unilateral change in the *number of persons whose capacity for exchange exceeds that of the marginal pairs*. For this last change brings about a disturbance of the equilibrium, it necessitates the exclusion of one or more competitors, and it introduces different elements into the factors determining the marginal pairs who, in turn, directly bring about a determination of price.

#### Only One Law Determines Price, Not Four

All this brings us face to face with the question as to the relation which exists between the price law we have developed for cases involving two-sided competition and the three other formulations of law pertaining to the simpler cases of isolated exchange and one-sided competition. Must we deal with four independent laws governing no fewer than four different varieties of price phenomena?

The answer is, that we do not. The formula last worked out includes all those applying to earlier cases. It is the most complete of the four formulations and expresses a conformity to a single law which just as truly underlies all the earlier cases. It is merely that those earlier cases represent a simpler, nay, what one might term a stunted combination of facts, and that the law therefore appears in a somewhat stunted form. For inasmuch as in the earlier cases certain elements, which the complete formulation declares to be price-determining, are entirely lacking, there is therefore quite naturally a smaller number of limits which fix the range within which the price must be set. But all those price-determining elements which are present at all, exert their influence in exactly the same way as they do in the case of the principal formulation.

#### A Summary Of The Psychology Of What Happens In Price Determination

Let us review. Of all the results we have attained in this chapter, the one that is by far of greatest import is the fact that all the influences which function in the determina-

tion of price have been resolved into subjective valuations and a rational appraisal of their functioning. And I do really believe we have here hit upon the simplest and most natural, and indeed the most productive manner of conceiving exchange and price. I refer to the pricing process as a resultant derived from all the valuations that are present in society. I do not advance this as a metaphorical analogy, but as living reality. To begin with, in the pricing process there are genuine *forces* in action — not physical forces, of course, but psychological. They are the *desires* which those wishing to buy harbor for a good and which those wishing to sell harbor for the money to be obtained for the good. Naturally the intensity of this force is measured by the magnitude of the utility which the individual promises himself from the desired good in the furtherance of his welfare — that is to say by the (absolute) magnitude of the subjective *value* which his valuation accords it.

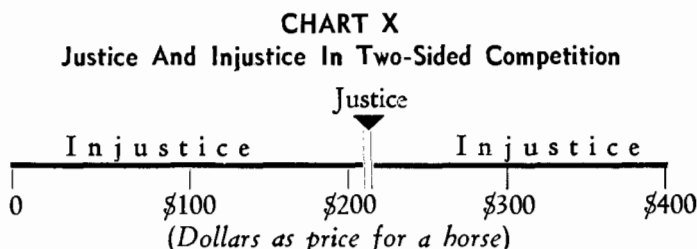
Now the market is the place where reciprocal cravings for goods belonging to others may legally be translated into effective action. But those forces cannot go into action in untrammelled strength, for each is accompanied by a certain inhibition. That inhibition consists in the desire to retain possession of what is one's own. The exchange goods of others cannot be acquired without parting with something of one's own. The more difficult it is to persuade oneself to take the latter step, the more strongly is the impulse toward the former inhibited. The intensity of the inhibition, of course, is in proportion to the importance possessed by the good to be parted with, for one's own welfare — that is to say the magnitude of its subjective value.

All that follows then becomes quite simple. Competitors who have the smallest capacity for exchange feel the inhibition to be stronger than the force and therefore the latter, being completely inhibited, can exert no effective influence in the way of external results. These individuals neither effect an exchange, nor can they exert any influence on the conditions under which others consummate exchanges. In the case of competitors with greater capacity for exchange the avidity with which the goods of others are coveted is stronger than the desire to retain what is theirs — the force is greater than the inhibition. There remains therefore an excess of force which in their case leads to an actual transfer of goods. Now this very excess of force, which is greatest in the competitors possessing the greatest capacity for exchange would in and of itself be capable of influencing the determination of price in direct proportion to its own magnitude. But this perfectly understandable interest of the competitors having greater exchange capacity does not by any means go so far as to induce them to offer as much as in the most extreme case they *can*. Rather does it move them to offer barely as much as they *must* in order to succeed. They "succeed" in this case if they force out supernumerary competitors and thus assure for themselves a place in the ranks of those effectively consummating an exchange. And so they deliberately refrain from setting in motion the full force of their superior power an exchange, and are content to do just so much as the least of their own number is capable of doing and is compelled to do in order to maintain his superiority over the competitor next behind him. And therefore it comes

about as a perfectly natural result that the standard for the determination of price is derived from the economic situation of the last of the "ousters" and the first of the "ousted," or as we expressed it earlier, from the subjective valuations by the marginal pairs.

### The Range Of Justice In Two-Sided Competition

A chart can now be drawn similar to Charts III, IV and V, but in this case of two-sided competition, to show where "injustice" ends and where "justice" exists.



*The higgling of the market has been narrowed by competition to a range between \$210 and \$215. Bargaining strength and skill has, by competition, been restricted to this limited range.*

But below \$210 and above \$215 the price will be "unjust" because then either some seller or some buyer will be coerced. Justice is not compatible with coercion.

(To be continued)

## The Market Price Of Freely Reproducible Goods

Two-sided competition between buyers and sellers of *horses* has been described in detail in the foregoing. That description pertained to a situation as of a particular day. On that day there were eight would-be sellers and ten would-be buyers of horses.

On the next day, however, the situation might turn out to be radically different; there might be more sellers and less buyers, or vice versa. The market is, if men have freedom, in a constant flux.

Let us assume that the market of horses is "good," that is, that the price is greater than the cost of breeding and growing them. Then, because the production of horses is profitable, producers of horses will increase breeding operations. But the supply of horses will not be greatly increased by that process in less

than 4 years. The gestation period of more than a year cannot be reduced, and a horse is not considered mature until three years old. Furthermore, mares seldom have more colts than one at a time. In the case of horses, the supply, therefore, is not, quickly adjustable to demand.

Sometimes, the supply is adjustable even more slowly than in the case of horses. In other cases, the supply may be adjustable more quickly. It depends on the item.

The more quickly that supply can be increased profitably to meet strong demand, the sooner there will be sellers who will "exploit" the good margin between selling price and costs, by increasing production.

In other words, the price of all freely reproducible goods tends to be lowered by suppliers, by their increasing production to a point that the marginal pairs set a price so that no more will be "earned" from selling that item, than the modest originary interest of 5%, more or less.

There is, therefore, a constant tendency for prices of freely reproducible goods to be reduced until they are only slightly above costs. *Abnormal* profits are like bubbles in ginger ale, which effervesce and disappear.

The situation is, of course, radically different in the case of an item the supply of which *cannot* be increased. Similarly, too, an unusual margin of profit may be retained if the seller has a monopoly position, or if a group of sellers combine to form a monopoly. In these latter two cases, the price situation is that described under "one-sided competition among buyers," on pages 315-317. When there is *one* seller and *many* buyers, the lone seller has the "whip hand."

## Reprint Of Böhm-Bawerk's "Value And Price"

Böhm-Bawerk devoted 135 pages in his *Positive Theory of Capital* to the subjects of *value* and *price*. In preceding issues and in the foregoing only a small part of what he wrote has been quoted.

*Positive Theory of Capital* is the second volume in Böhm-Bawerk's three-volume work, which has the general title, *Capital and Interest*.

A paperbound reprint of "Value and Price" is available at



the price of \$2, from the Libertarian Press, South Holland, Illinois, U. S. A.

Böhm-Bawerk is one of the greatest economists in the history of economic thought, and his writings are generally esteemed as classics. The section on "Value and Price" is one of the most distinguished sections in his famous work.

## Moses And Christ As Realistic Thinkers

The General Versus The Specific

How Christ Avoided Careless Thinking About Brotherly Love,  
A Term Otherwise Validly Under Critique, According To  
Occam's Razor

The Meaning Of Love In The Sexual Or Conjugal Sense.  
(An Illustration Of An Occamish Approach.)

Justice, As A General Term To Be Looked At Skeptically,  
From The Viewpoint Of Occam

### The General Versus The Specific

There is some talk in the Old Testament about *brotherly love*, but it is not extreme. Instead, there is emphasis on specific *rules for action*, Thou shalt not do this or that. The real emphasis is on the "law and the prophets."

In the New Testament the words, *love* and *brotherly love*, are scattered profusely through its pages. The new formulation of the command concerning brotherly love is here mostly *general*, namely, Thou shalt love God above all, and thy neighbor as thyself. A proper question is, what do those two *general* statements about love mean?

The word *love* is not defined in the statements about loving God most, and neighbors equally with the self.

In regard to the second of them, the common assumed interpretation of the word love is: have a subjective attitude of goodwill toward all men.

*Rules for action*, about which Moses was admirably explicit in the Old Testament, appear to have had a tendency to become a *vague sentiment* in the New Testament. The specific negatives, *Thou shalt not*, appear less important, and instead we have a high-sounding positive, *love thy neighbor as thyself*. The later formulation of the rule is much inferior, as a guide for *action*.

Whereas in Moses's time there was limited patter about brotherly love, and in Christ's time there was considerable conversation about it, Christ and His contemporaries realized that

they would, unless they were careful, merely be playing with words, and that their use of the word, *love*, was in danger of becoming meaningless.

In the twentieth century, in our own day, there is much ethical and religious patter about brotherly love, but there appears to be lesser awareness among us that now the word is too general to be meaningful; or *at least its present meaning does not agree with its meaning in either the Old or the New Testament.*

From something explicit, the trend of the meaning has been, first, to the vague, but the character of the trend was clearly realized by Christ; since then the trend has gone further so that those using the word *love* sometimes appear merely to be mouthing a word, or are giving it a new meaning.

It took 1400 years, from Moses to Christ, for the use of the word *love* to become vague, and then another 1900 years (from the time of Christ until now) for people to develop a rather dubious definition of it.

Christ and some of his contemporaries were aware that the word *love* might be no more than the sound made by a gust of air blown out by a person from between his lips; that, and no more. When in the New Testament there is a record of a discussion of *brotherly love*, then one of those participating in the discussion usually asks, "How readeest thou", that is, what does it really mean to "love the neighbor as the self."

To that inquiry the invariable answer is, Thou shalt not kill, commit adultery, steal, lie, covet. These *specific* negatives constitute love. These negatives (as distinguished from generalities) can easily be re-phrased into positives, as follows:

Negatives	Positives
Thou shalt not kill (nor commit violence, nor engage in coercion) ( <i>Sixth</i> Commandment).	Every man shall retain his liberty, unharmed himself and unharmed to others.
Thou shalt not commit adultery ( <i>Seventh</i> ).	You may possess sexually the mate for whom you have undertaken responsibility.
Thou shalt not steal ( <i>Eighth</i> ).	You and your neighbor are entitled to be protected in the possession of your respective property.

Thou shalt not bear false witness (*Ninth*).

Thou shalt not covet thy neighbor's house, wife, etc. (*Tenth*).

What you tell your neighbor must be the truth; otherwise remain silent.

There is plenty in this world to possess by honest labors and exchange; the world, rich in many things, is available to those who work and exchange, without man poisoning his mind with envy, or injuring his neighbor in the process.

Christ invariably indicated that the word *love* lacks meaning, or that it is incorrectly understood, *unless it at least means exactly what Moses specified in the Law*. In other words, the word *love* is a general term; in contrast, the commandments of Moses are specific. The latter give meaning to the former.

Christ, it should be noted, in the Sermon on the Mount indicated that He did not come to subtract anything from the Law, but He affirmed He was speaking in a manner to broaden its application so that its universality would not be restricted (as it had been by the prevalent erroneous interpretation, which practically annulled the further application of the commandments once they had been broken). Christ declared what was the proper extent of the application of the commandments. That was the new emphasis which He provided. The misinterpretation, and the lessening of the virility of the law, had long been accomplished by the assumption that *B*, if he had been injured by *A* (in regard to the commandments in the Decalogue), was *freed* from the law, and might retaliate and avenge. Christ disputed that, and declared that the Law remained in effect for *B*, even though *A* had violated it; further that *B* by his actions should forgive *A* and be forbearing toward him. (See Volume I, pages 28-144, for extensive discussion of this subject.)

Christ broadened the application of the Law, and universalized it for all thoughts, words, and deeds.

But, when talking about *love*, He passed quickly and completely, from the mere gust of air that came from His lips when He pronounced the word *love*, to the question of specific conduct meant by the term, as specified in the commandments in the Mosaic Law.

### How Christ Avoided Careless Thinking About Brotherly Love, A Term Otherwise Validly Under Critique, According To Occam's Razor

William of Ockham (in England) (1270?-1349?), or Occam as he is usually known, a Franciscan friar and general of the order, who was dubbed the Invincible Doctor, is the man who tolled the deathknell to a type of thought which for centuries had plagued Christianity, the type of thought known as scholasticism (especially that phase of scholastic thought known as *realism*, a misnomer for most people, who assume from the name that it is true realism).

Scholasticism was an incompatible combination of Hebrew-Christian and Greek thought. The ethical content of scholasticism was substantially Hebrew-Christian, but its methodology, its intellectual slant on life, was that of Greek philosophy. For Plato, the *general* had been more real than the *particular* or the *individual*; (the general idea, *man*, was more real than a *particular man*). By shifting from the *particular* to the *general*, men deceived themselves into believing that there existed a reality beyond the particular; the general *concept* or the *idea* was alleged to refer to a *mystical* "reality." But what the so-called realists deluded themselves about as being intellectual reality was unhealthy mysticism—a figment of the imagination, and only *externally* more respectable than plain superstition.

The church father, Augustine, who prior to becoming a Christian had been a neo-Platonist, had more or less led the way in bringing into sober Hebrew-Christian thought the mysticism—unreality—of the "great ideas" of Plato.

Occam attacked that mysticism—absurdity—under his famous expression, *Entia non sunt multiplicanda praeter necessitatem*, that is, do not substitute a mystical generality (which is a mental creation or figment, and not reality) for specific cases. An English translation of the Latin of Occam might be, *Entities (ideas on reality, names) should not be multiplied beyond necessity*; but that translation does not say more to many of us than the original Latin formulation.

Other ways of endeavoring to elucidate the idea of Occam is to say: (1) selecting a new name does not add to the existence of external reality; (2) a *general* name (such as *love* or

*justice*) may befuddle thought by its generality, whereas what really counts are the *specific* things or actions to which the general terms should be intended to refer; or (3) a new name is not necessarily a new idea; or (4) *general* terms have an ambiguity in them which hinders clarity of thought; or (5) general terms and general concepts lack reality; the general is not real; the only real things in the world are the specific cases; or (6) if you think in terms of specific things or actions you are confining your thoughts and declarations to the real world, whereas when you think in terms of general classes and ideas you are entering a potentially unreal, abstracted, sometimes imaginary, often hallucinatory, and even fictitious world.

Once Occam had discovered not only the specific fallacy — mysticism and hallucination — involved in using general terms in place of specific terms for specific reality — he apparently became aware how universal the fallacy which he had noted was in the thinking of his contemporaries and his predecessors. Eventually, he appears always to have been looking for more and new evidences of the prevalent, almost all-pervading, intellectual disease of his age. His slogan, and his method of critique, became known as *Occam's Razor*, the best razor-sharp way to cut the ideas of imaginative thinkers and mystics into ribbons that had been discovered since the dawn of civilization, his *Entia non sunt multiplicanda praeter necessitatem*.

There can be no doubt that the term *brotherly love* is a potential violation of Occam's slogan. It is a *general* term. Either the users of the term are merely mouthing two words (1) with a meaning so vague that they are really saying little; or (2) they are using the term, now to cover this idea or now another, either or both of which may be wrong; or (3) they think they have discovered a new idea covered by their term, and they delude themselves that they have *discovered* something—like Sir Isaac Newton discovering the laws of gravity—and then they flatter themselves that they are original thinkers. Instead, they are merely neologists, developers of a new word, a sound emitted out of their lips, and a gust of air forced out of their lungs—a *word*, not a *reality*.

If Occam had lived in the time of Christ and had heard

some of the patter about brotherly love, he probably would have set about debunking it, just as the term needs debunking today. But if he had overheard the conversation between Christ and the lawyer recorded in Matthew 22:35-40, he would have made the comment, "There is no fallacy here"—the term, *brotherly love*, is here defined in *specific* terms, namely, in the six specific commandments at the end of the Decalogue.

And one of [the Pharisees], a lawyer, asked him a question, trying him: Teacher, which is the great commandment in the law? And Christ said unto him, Thou shalt love the Lord thy God with all thy heart, and with all thy soul, and with all thy mind. This is the great and first commandment. And a second like unto it is this, Thou shalt love thy neighbor as thyself. *On these two commandments the whole law hangeth, and the prophets.*

The identification, in the last sentence in the foregoing, of the *general* commandment, to love the neighbor as the self, with the *specific commandments* in the Second Table of the Decalogue is universally accepted.

A customary practice is to read in Sunday services first the Decalogue, and then to add to that, *as referring to exactly the same thing*, the appropriate part of the quotation in the foregoing. *Decalogue and love are identical.*

Clearly, Occam's law was honored by Christ rather than breached when He indissolubly tied the word *love* to the Decalogue. Words were not piled on words by Christ, nor was a generality substituted for what is specific. Here was no Platonic vagueness. The expression (to love the neighbor as the self) was not something new, but only a summary of the specific commandments, and the summary was defined in specific and explicit terms (the Decalogue).

Although Christ lucidly avoided exposing himself to the fallacy that Occam in a later age formulated against dangerous generalities, the same cannot be said of the Christian church in the twentieth century. Now, to love the neighbor as the self is a term which has been extended in many directions beyond what Moses wrote and Christ interpreted. (For evidence, see earlier issues of FIRST PRINCIPLES.)

The foregoing pertains to *brotherly love*.

**The Meaning Of Love In The Sexual Or  
Conjugal Sense. (An Illustration Of  
An Occamish Approach)**

The word, love, is about as equivocal as any in the language, and has almost every shade of meaning. It is unfeasible to consider them all, but the obliteration of distinctions between brotherly love and sexual love, by means of a *generalization* of both terms, the route that Occam condemned, is so common that it is worth defining the term *love* in the sexual sense specifically, and thereby avoiding the fallacy at which Occam was consistently aiming his condemnation.

What is *conjugal* (honorable sexual) *love* between a man and a woman? A sentiment? a feeling? an exchange? a deal? Is it some vague emotion that is properly left nonspecific and undefined?

The substance of conjugal love—ignoring the emotional suspense that makes people act perfervidly toward each other during courtship—(looked at from a man's viewpoint) is: (1) *exclusive* sexual access for him to her; (2) conviction that her children are his and not another's; (3) her detailed care of those children; (4) cooking, laundry, housekeeping services; (5) aesthetic services by her (that she is pleasant to look at and possess as an ornament); (6) companionship. There are probably more, specific items which should be included, but the foregoing will suffice.

A man, therefore, loves a woman as his wife, *for what he gets out of it*. Any other definition is malarky. It is not necessary that every one of the foregoing benefits to a man be available in ample measure for him still to love her some. But let the wife chip away at these specific items and his "love" for her diminishes and may disappear. His *love*, therefore, is his satisfaction with the "services" he is getting from her. Reduce the services and his love disappears.\*

Consider the contrary: give the husband the conviction that he does not have *exclusive* sexual access to his wife, but that others have too; have him reach the conclusion that the children

\* Reference here is to deliberate and willful reduction of services by a wife. The essence of marriage includes forbearance by mates to each other in regard to services lost by causes beyond their control, such as illness, catastrophe, and even to services lost because we are all fallible.

she bears are not his; let his wife neglect her children; let her neglect cooking, laundering and housekeeping; let her no longer be attractive as a person, but become unornamental and a disgrace to him; and/or let her desert him so that he is robbed of her companionship (available otherwise practically on demand), and then what? His love will wither and die.

He may in protest at first fight with her, abuse her, divorce her, neglect her, or desert her; but he certainly will not "love" her fervently any more, unless there is something pathological in his love. What he thought was "love" was the getting of the "services" listed earlier. His love was a manifestation of his concern for his self-interest. When his self-interest was no longer reasonably served, his "love" tended to disappear, too.

Because a man gets, or hopes to get from his mate, the services previously listed, he in return gives her exclusive sexual services; he treats her with kindness; protects her; supports her; gives her gifts; compliments her; shows her that he is dependent on her; and tells her all the exaggerations (how he l-o-v-e-s her) that she, womanlike, wishes to hear. Such is the coin in which he pays her, which is why she in response "loves" him — that is, for what she gets out of the marriage.

Such (we assume) would be Occam's realistic approach to conjugal love. He would look with suspicion on the use of the word *love* by some young gallant to some maiden when he says, "I love you," in order to obtain sexual access, without marriage, support, permanent companionship, and all the rest.

When do people make a truly Occamish approach to sexual love, deliberately and explicitly? When do they endeavor to escape the humbug that may be in a mere word? When do they, in practice say, *Entia non sunt multiplicanda praeter necessitatem* in regard to sexual love? When they have a daughter who is being courted by a rogue, who tells the daughter, *I love you, but he does not mean by that word the specific contents that the word love ought to have*. If, contrarily, the young man undertakes honorably to do the things listed in the second preceding paragraph, then the parents usually welcome the courtship of their daughter by the young man. *Parents, when it is a matter of their daughter's welfare, all become sound Occamites.*



### Justice, As A General Term To Be Looked At Skeptically, From The Viewpoint Of Occam

Everybody wants at least *justice*, at all times, in all places, and under all circumstances. And what is *justice*, if there is to be progress beyond the mouthing of the word? What *specifically* does *justice* mean, in exchanges of goods and services between men; that is, what is justice in business?

Plato (in his *Republic*) through the device of a dialogue in which Socrates is his spokesman) defines justice (in a general sense) as every man getting his due and being assigned to his proper station in life. That definition is satisfactory as far as it goes, but the Delphic Oracle of the Greeks never gave a more ambiguous and valueless statement on any subject. The definition merely states a goal, that every man be assigned to his proper station in life. But what is *his* proper station? and *how* is his proper station to be obtained by him? Neither Socrates nor Plato answered those determinative questions. Their "wisdom" was not wisdom, but an oracular mystery, worthless and without merit.

The Christian religion does not equivocate on the subject of justice, as did the Greek philosophers. Hebrew thought was always more down-to-earth than Greek thought. The Christian religion explicitly concerns itself with *how* a man is to get out of life what is his due.

*Economic justice*, as well as justice generally, if it is not to be slashed by Occam's Razor, *must be something specific*. In the foregoing, Böhm-Bawerk was specific about prices.

*Liberty* is not an *end* but a *means*. It is not a high and exquisite happiness to which order, property and morality should without one scruple be sacrificed. It is merely valuable as the safeguard of order, of property, and of morality.

Rephrased from MACAULAY's essay on "Mirabeau."

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# FIRST PRINCIPLES IN MORALITY AND ECONOMICS

*on which depend personal well-being and social health and harmony*

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VOLUME VI

DECEMBER, 1960

NUMBER 12

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## Announcement Regarding "First Principles In Morality And Economics"

FIRST PRINCIPLES IN MORALITY AND ECONOMICS, after having been published *monthly* for six years, will no longer be published on that basis, but either quarterly or irregularly. A specific decision regarding the future schedule has not yet been made, and the ultimate decision will depend on circumstances.

The ground for the foregoing decision to lessen or interrupt the publication schedule of FIRST PRINCIPLES is based on a practical consideration, to wit, the preparation of the material appearing in FIRST PRINCIPLES consumes too much of the publisher's present available time.

The presentation of material in separate issues of FIRST PRINCIPLES has been fragmentary, but in perspective the material itself will be found to be systematic. This is the situation also, despite a change of name. For the first four years the title

was PROGRESSIVE CALVINISM; for the latest two years, FIRST PRINCIPLES. The original title was unnecessarily sectarian; Calvinism is only a part of Christianity; further, much of the material content has been ethical, which is as valid for a Mohammedan, Shintoist, Buddhist, etc., as for a person nurtured in the Hebrew-Christian religion\*.

The format of FIRST PRINCIPLES was selected so that the twelve issues in each year could be bound in book form. Paper-bound copies of the six years are available at \$3 a copy. Copies of some monthly issues are yet available; the supply of others is exhausted.

This publication has been a hybrid—a cross between Hebrew-Christian ethics and neoclassical economics. Much of the ethics presently taught in Christian churches is here evaluated to be (1) neither a correct interpretation of what the Hebrew-Christian religion teaches in regard to proper conduct toward fellow men; nor (2) reconcilable with an internally consistent science of the relation of men to things, that is, with a science of economics.

When the Christian church discovers that it is suffering loss of prestige and influence in the practical world, in the world of human action, then it should also realize that that may in part be ascribable to its ethics being unscriptural and sanctimonious, and inconsistent with the ends allegedly aimed at.

### **The Ambiguous And Defective Dictum, "Supply And Demand Determine Price"**

Men naturally undertake to be practical economists. They confidently declare that "supply and demand determine price." Their statement can be quite right, but it is desirable that they and their hearers know what that proposition really means. Anyone, however, who has mastered the material on supply and de-

\* Some of the material in the earlier issues was even denominational and individual in character; however, that aspect of the material should be appraised as being *illustrative of general trends and attitudes*, and therefore, in that sense, of wide rather than narrow significance.

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mand as presented in the preceding three or four issues of *FIRST PRINCIPLES* (where *value* and *price* have been discussed), will realize that whoever says "supply and demand determine price" does not necessarily fully understand what he is saying, unless he analyzes *price formation* in the manner in which Böhm-Bawerk (who was quoted) has done it. The formula, supply and demand determine price, may be little more than empty sounds.

The words, *supply* and *demand*, are "objective." But price is determined by *subjective evaluations*. Instead of the old cliché, supply and demand, it would be better to substitute, "Suppliers and demanders determine price." The rephrasing emphasizes that people, and not things, determine prices. For something to have value somebody must need it, know that he needs and wants it, and the supply of what he wants must be sufficiently limited so that the thing is scarce, and consequently not a free good.

Substituting the term, *suppliers and demanders*, for the other term, *supply and demand*, although a gain in terminology, still is unsatisfactory. Böhm-Bawerk showed, in what was quoted in the previous issue, that not all *suppliers and demanders* affect the price. Finally, it is *only the marginal pairs of buyers and sellers* who determine the range within which the price will settle. The many excluded would-be buyers and sellers have no effect on the price, except the members of one of the marginal pairs. Those buyers and sellers who do have a greater capability for exchange than the marginal pairs *indirectly* affect the price by determining who the participants in the marginal pairs will be, but the price itself is not directly determined by the former.

And so, having first abandoned *supply and demand* for *suppliers and demanders*, it is necessary secondly to abandon that formula, too, and substitute for it, the *marginal pairs of buyers and sellers determine price*. But few of the many who facetiously say, supply and demand determine price, have knowledge of what is meant by *marginal pairs*.

Statements, then, about supply and demand, in a general slogan may be almost meaningless to people who use *general terms* the content of which they may not adequately understand, and which they have probably not dissected or analyzed in a specific case, in a manner as Böhm-Bawerk (with various simplifying assumptions) analyzed an assumed "market" for horses,

with ten would-be buyers and eight would-be sellers. Even that *simplified* analysis (quoted in *extenso* in the November issue) may not be adequately understood by readers (i.e., fully enough to be employed by them in practical cases).

People who learn the theory of the formation of prices are not necessarily the shrewdest traders who somehow or other come off better than the rest of mankind when they buy and sell, but at least they can have a conscious method of analyzing markets as Böhm-Bawerk did, and consequently become better buyers and sellers than they were formerly. If a man is unable to make more money for himself hereafter, from Böhm-Bawerk's method of analysis, when buying and selling, then he probably remains in the class of those who repeat the words, *the marginal pairs determine price*, but those words are really mere sounds just as are the words in the declaration: supply and demand determine price.

He who buys and sells better after having read Böhm-Bawerk's analysis of price formation than he did before (assuming he is active in business), really knows what it means that the marginal pairs determine price.

## Confusing Cause And Effect In Price Formation

A fruitful cause of intellectual confusion is to see that there is a *cause and effect* relationship between two things, but to reverse the relationship, and consider that that which is really a cause is an effect and that that which is an effect is a cause.

Parents of an adolescent son may marvel at his appetite, and they may "explain" the situation by saying that "John has a big appetite, because he is growing fast." On reflection, they might reverse the statement and say, "John is growing fast, because he has a big appetite." Clearly, the *effect* which John's parents have in mind is his "growing fast," and the immediate *cause* is his big intake of food.

In the sciences, cause and effect have frequently been "reversed" erroneously. This has happened conspicuously in the science of economics. One writer has written:

Malicious persons have been prone to describe [British Classical Economics], the system of political economy which Ricardo formulated and Mill made popular, as the cart-

before-the-horse system, . . . according as they were struck by the [frequency] with which that system mistakes cause for effect.

Ricardo, for example, taught that *costs determine prices*. It is instead the other way around, because the prices obtainable for finished merchandise determine which costs are tolerable; that is, demand determines prices. One way to formulate the difference between British Classical Economics and Austrian Neoclassical Economics is that the former says *costs determine prices*, and the latter says *demand determines prices*.

There can be no real doubt that the statement just quoted about British Classical Economics is essentially correct; Mill, Ricardo and their followers did, on the subject of price determination, confuse cause and effect.

Unfortunately, Karl Marx and his fellow-socialists indiscriminately accepted Mill's and Ricardo's ideas. Marx asserted aggressively that a cost factor—one important cost factor, namely *labor*—was the determinant of prices, or should be.

In confusing cause and effect in the the crucial field of prices, Mill, Ricardo and Marx made the same basic error.

## Justice And Injustice In Price Determination Under Four Different Circumstances

### Prices Under Four Different Circumstances

In the October and November issues extracts were presented of Böhm-Bawerk's analysis of the price that will prevail for a horse or horses under four different circumstances: (1) isolated buyer and seller, (2) one-sided competition among buyers, (3) one-sided competition among sellers, and (4) two-sided competition.

In isolated bargaining the price of a horse (under Böhm-Bawerk's assumptions) can vary in a wide range, between \$100 and \$300.

Under one-sided competition among buyers, the prices will fall in a higher and narrower range, between \$280 and \$300.

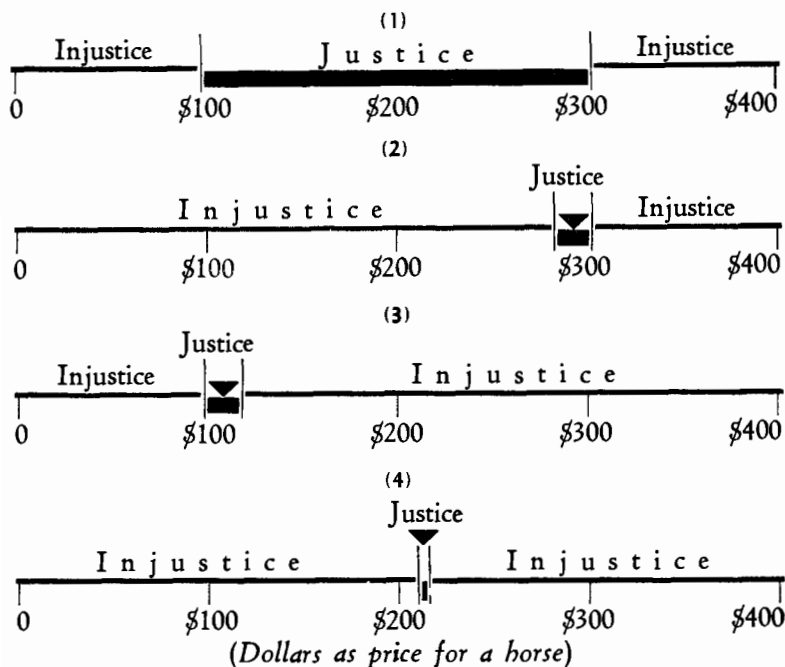
Under one-sided competition among sellers, the price will fall in a lower and narrower range, between \$100 and \$120.

Under two-sided competition, the price will fall in a middle and very narrow range, between \$210 and \$215.

Chart I shows the foregoing, graphically.

# **CHART I** **"Just" and "Unjust" Market Prices for Horses** **Under Four Circumstances**

- (1) Isolated Exchange
- (2) One-Sided Competition Among Buyers
- (3) One-Sided Competition Among Sellers
- (4) Two-Sided Competition



1. When there is one buyer and one seller, the range in which the bargaining takes place can be very wide. The trader who is better, or bolder, or more ruthless, can force the price far in the direction of his own idea of what the price should be, and far away from what the other man would like the price to be. (See the heavy portion of the first horizontal bar in Chart I, which shows the range in which the price can fall.)

2. When there is *one* seller but *many* buyers, the seller has a heyday. He easily obtains a higher price, not because he is a better, bolder and more ruthless trader, but *because the buyers compete with each other by outbidding each other*. To get a high price is not evidence that a man is an extortionist and hardhearted;

it often is nothing more than evidence that buyers consider it to be for their own good to outbid each other. It is not so much the seller who extorted for himself the higher price; instead he received the higher price effortlessly because of the eagerness of the several buyers. (See the heavy portion of the second horizontal bar in Chart I.)

3. When there are *many* sellers and *one* buyer, the situation is reversed. The sellers under-sell each other. A low price is not conclusive evidence of skillful and heartless pricing by the buyer; it may instead be evidence of eagerness of sellers to sell. It is for that reason that the price of the horse that is sold will be lower. (See the heavy portion of third horizontal bar in Chart I.)

4. When there are *many* buyers and *many* sellers, the range in which the buyers and sellers can be "tough" toward each other is narrow. The range in our example became a trifling \$5 compared to \$200 in isolated trading. Skillful and ruthless traders have no real range in which to "extort" from another what their intelligence, wealth or strength might induce them to attempt to "extort." The "market" restricts them. (See the small heavy portion in the middle of the fourth horizontal bar in Chart I.)

### Definition of Justice and Injustice

The four horizontal bars in Chart I are divided into sections labeled "Justice" and "Injustice." The terms need definition.

What is *justice* in price determination? That no buyer *coerces* a seller beyond the limits that the seller is willing to go; and vice versa, that no seller *coerces* any buyer beyond the limits that the buyer is willing to go.

Readers who have not read the preceding two issues may not fully realize that that is an absolute requisite for justice. Justice assumes *noncoercion*, and therefore noncoercion is part of the definition of justice. Every buyer and seller, by this definition, himself *wishes* to be a buyer or seller at the price that prevails. Every actual buyer and seller prefers to pay the price he is paying or receiving, versus not trading at all. Every buyer and seller, according to his own estimation, *gains* by the transaction. He trades *willingly*. The market he creates or helps create is, in that sense, a *free market*.

### What Justice Does Not Include

But the term *justice* in price determination does not assume



some things. It may be well to be explicit about that.

1. First, it does not assume equality of circumstances. It assumes instead inequality—one man wants a horse, and another man with a horse to sell wants something in place of his horse. The valuations of the participants in the market will necessarily be different.

Prayers in churches on Sunday should give thanks to God that He made us different from each other, and put us all in different circumstances. That is even better thanksgiving than that the church members are all "one body." The fact that we are different is the basis for exchanging, and the opportunity of exchanging is the principal basis for people associating together. Society depends on mutually beneficial exchanges. Civilization and a high standard of living depend on inequality or disparity, on differences in values between people. We help each other more—show "brotherly love" to each other more—by *voluntary* exchanges than by any other activity. (See what has been written about Ricardo's Law Of Association or Cooperation, in Volume IV, numbers 7 to 10.)

2. Nor can justice in price determination assume that there is perfect knowledge by the participants of the ultimate wisdom of what they are doing. There is no perfect human wisdom. We have only partial knowledge. Every man must engage in exchanging and trading according to his own "light." That some have more light and others less is inescapable.

Every man must be his own judge when he buys and sells. That responsibility is accompanied by some undesirable features. The alternative is that another makes the decision for the first man. But such an arrangement, that we are our brothers' keepers, is accompanied by even more undesirable consequences. The abuses of paternalism and mandatory control over others are worse than the abuses of freedom. It is safer to rely on protecting the self than to rely on protection by others.

### **The Concomitant Of Justice**

But the further question may be asked: Is nothing more to be relied on than atomistic competition, and is it always: every man for himself only?

To have that perspective of a free market is to fail to see its character clearly and realistically.

The bid prices by other buyers in a free market are educational for a particular buyer; his fellows truly help orient him. Similarly, the offering prices by other sellers in a free market are educational for a particular seller. "Free markets" daily teach more than do the schools of the world. Free markets are for the efforts of mankind what the north star is to the sailor at sea; free markets tell what should be done—produced, transported, discontinued, increased or decreased. Buyers really help other buyers; sellers really help other sellers. And likewise buyers even help sellers, and vice versa.

The more-standard that merchandise is, and the greater the number of buyers and sellers that there are, the safer the world is for the foolish, weak, inexperienced and imprudent. It is the existence of *nonstandard* merchandise, bought and sold in *isolated* markets, which potentially contributes to injustice in buying and selling. The highly organized markets for standardized, graded merchandise, which are characteristic of the modern world, work toward frustrating injustice.

### The Alternative To The "Market"

That the "market" is not a *perfect* ideal for "just" exchanging is undoubtedly true. In this world, in which fallible men are neither perfectly good nor wise, the only other standard is whatever other alternative may be available.

There is only one such alternative available for those who are buyers and sellers. That alternative is a "fixed" price established without freedom on the part of the buyers and sellers, a price which therefore must be coercive and compulsory.

Such an ideal of a fixed or administered price, for which many devout moralists and religionists seem to yearn, requires that the agency selected to establish that "just price" know, in a Godlike manner, the marginal utility of each unit of goods to be traded, for every potential buyer and seller, and then to match such data so perfectly that the ideal price, presumably the "just price," is arrived at. But whoever has followed the reasoning of Böhm-Bawerk, as quoted in the two preceding issues, will realize that no *human* agency (other than the many participants themselves) can possibly arrive at a wise or just price, even in the (almost artificially) simple circumstances that Böhm-Bawerk assumed in order to keep his explanation simple.

The erroneous assumptions, therefore, underlying an administered price—administered say by a fallible, not-too-well-informed, seducible bureaucrat—for the purpose of obtaining a vainly hoped-for “just price,” include (1) the unrealistic assumption of the existence of the practical omniscience of the bureaucrat (to know the marginal utilities of each buyer and seller); (2) that such a price could and would be changed simultaneously as circumstances and marginal utilities change; (3) that the selected price may be made *coercive*.

Of those three features characteristic of a controlled price, the first is the most important. However, that requirement of omniscience *cannot* be met. Nor the second requirement either.

The *coercion* involved, contrarily, can be partially eluded by everybody involved. A man takes into account, as much as he can, by how much a coercively set price is against his interest, and, according to legitimate self-regarding motivations, endeavors to “elude” or “avoid” disadvantage to himself from such a price. There is a *law* which comes into play against *coercion*, namely, motivation based on legitimate “self-interest.” That is the “natural law” in the social sphere, as physical laws are the natural law of the material world.

#### **What Is The Ideal Price Or The “Just Price” For Which Men Yearn**

1. The ideal just price is a *variable* price. In an ever-changing world, the ideal of a fixed price is unsound.

2. The ideal just price, further, must be based on the *subjective evaluations* of *all* participants concerned. Only the participants themselves will know what those evaluations are.

3. The subjective evaluations of all participants will determine what for them the point of *marginal utility* is, for each product, at a particular time and place.

4. The “discovery”—the revealing—of the various marginal utilities cannot be a mass revelation, but can only be expected to be revealed by buyers gradually overbidding each other, and sellers gradually underselling each other. Eventually, by piecemeal disclosure the “market” will be “revealed,” and buyers and sellers will be “matched,” as was analyzed on pages 331-344.

5. The price at which the “matching” occurs is the only just price determinable according to accepted principles of morality.

Such a "just price" will never be *perfect*, until men have become so perspicuous in their judgment, so well informed on all their future needs, that they are perfect in their *subjective evaluations*. There are no such men and never will be in this dispensation. To assume that perfectly just prices exist, or will exist, is to assume the impossible.

## Justice — And Mathematical Averages

Prices may be determined in "isolation," that is, arrived at by bargaining taking place between two people, alone by themselves, without contribution by others; or they must be arrived at in a "market", that is, arrived at by many buyers and sellers mingling with each other in the bargaining process.

In the first case, we are dealing with a *specific* price. In the second case, we are presumably dealing with a price determination which involves *averaging* of some sort. A natural question arises: What kind of average is developed out of the free market process, and how meaningful and "just" is that average? The answer is not difficult to discover and will be illuminating. For the following analysis, we shall use the data on horses appearing in Table I on page 323, in the November issue. For convenience, the table is repeated here.

TABLE I  
Buyers And Sellers Of Horses In Two-Sided Competition

Ten Willing Buyers		Eight Willing Sellers	
Designation	Each Man's Valuation Of One Horse	Designation	Each Man's Valuation Of His Horse
Aa	\$300	Ba	\$100
Ab	280	Bb	110
Ac	260	Bc	150
Ad	240	Bd	170
Ae	220 (a)	Be	200 (a)
Af	210 (b)	Bf	215 (b)
Ag	200	Bg	250
Ah	180	Bh	260
Aj	170		
Ak	150		

(a) "First" marginal pair.

(b) "Second" marginal pair.

Readers of the November issue will remember that under the situation described in the Table, five horses will be sold, to wit, the five available for less than \$215. The other three priced at \$215, \$250 and \$260 will have to be led home, unsold. However, as was made clear in the analysis, the second marginal pair that determine the price is the first excluded pair, to wit, Af and Bf, the sixth buyer and the sixth seller who were willing to buy or sell at \$210 and \$215 respectively. These two *cannot* get together on a deal because they are \$5 apart. Nevertheless, *they are the real marginal pair in the determination of the price*. They must be included in any *averaging*, in order to arrive at a price.

There are four well-known averages, (1) the popular average known as the *arithmetic mean*; (2) the *geometric mean*; (3) the *median*, and (4) the *mode*.

The *arithmetic mean* for the first 12 figures in Table I is arrived at by dividing by 12 the total of the twelve figures, that is, in algebraic form:  $(\$300 + \$280 + \$260 + \$240 + \$220 + \$215 + \$210 + \$200 + \$170 + \$150 + \$110 + \$100) \div 12$ . The next equation is  $\$2,455 \div 12 = \$205$ . This method of averaging has the effect of giving every item in the twelve equal weight in determining the average.

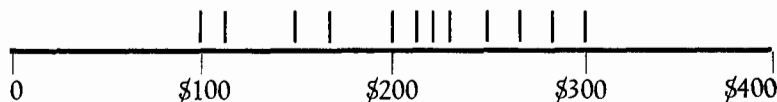
The *geometric mean* for the same figures is arrived at by multiplying the twelve numbers together and extracting the 12th root of the product, that is, (1) first multiplying  $\$300 \times \$280 \times \$260$ , etc., which gives a total of 2.921 septillions. When the twelfth root is extracted, the answer is 195. This method of averaging has the effect of giving *greater weight to the smaller items* in the series.

The *median* means the midmost number between the high and the low, if there is an odd number of items, e.g., the seventh if the total number were 13. But there are only 12 items in this series, and so we compute an arithmetic mean of the midmost pair, which is \$210 and \$215. The answer is \$212.50. This has the effect of *minimizing the extremely high and low items*.

The *mode* means that value where the items cluster together. To demonstrate the mode a chart should be drawn. See Chart II. Each column represents a buyer or seller. The cluster in this small series is between \$200 and \$220. We might call the mode \$210 (the midpoint between \$200 and \$220). The mode,

similar to the median, ignores the extreme values in the series and selects the value that seems to be most popular (is "in style," from which the term *mode* is derived). An average which is a mode will tend to be skewed on the low side; at least lower than the median.

CHART II  
Chart To Show The "Mode" Of Horse  
Buyers And Sellers In Our Example



It happens, because Böhm-Bawerk took a *typical series of prices*, rather than an exceptional series, that the results of all four processes of averaging fall in a rather narrow range, between \$195 and \$220. In actual life it does not always turn out that way.

When the question is asked: Which of these four averages on the basis of logic and "justice" should be used in pricing, then the answer can be found by a process of elimination. The geometric average should be excluded because it gives too much weight to the lower figures. The mode should be excluded because it is (usually) skewed. That leaves the arithmetic mean and the median. Between the two the final choice should be with the median because it gives lesser value to extreme figures than does the arithmetic mean. The median is the *midmost* figure, and is more typical and easily computed than any other average.

Which average, according to Böhm-Bawerk's analysis, is the one which is actually used in the price determining process? *The median.*

A market analyst who makes price analyses on the basis of arithmetic means, geometric means, or modes, does not follow a method in harmony with what really happens. Price analyses, in order to be strictly realistic, should be based on medians.

If the question is asked: What is the most important average in life, the common answer would be the arithmetic mean. But the most important average by far in the world is the *median*, because the exceedingly important price determining process consists in finding that kind of average.

When looking at the situation from a mathematical viewpoint, *the median value, for the participants in a market, is the most just value.*

## Labor As A "Commodity"

An American educated in the first half of the twentieth century will almost certainly have been taught that "labor is not a commodity."

The statement that "labor is not a commodity" is usually proclaimed with an air of righteous astonishment that the contrary is being considered, and with an attitude of indignation which appears to be intended to give evidence of religious protest against human "indignity." The writer, whose early youth was spent in a rural environment, far from centers of employment, was nevertheless definitely conditioned, by his environment, to that idea, to wit, "labor is *not* a commodity."

The conclusion which was intended to be drawn from that premise or principle was that the labor rate—the price of labor—was not to be determined by the ordinary laws determining the formation of the prices of commodities. The idea was that "labor" was peculiarly human, and that it should be treated on a basis different from commodities. But what that different basis should be was not specified, except that there was the inference that wage rates, to be determined by some noncommodity principle, should be more generous and more "just" than if they were determined by the laws of supply and demand which determine commodity prices generally.

However, as far as price-determining economic laws are concerned, labor is in the same category as commodities. This is not a question of doctrine, about which to be emotional, but one of making proper distinctions regarding facts. It should not be difficult to come to a solution which correctly looks at labor as a commodity, but which also removes the anxieties of moralists, social philosophers and theologians who afflict themselves with the fear that men are being demeaned into being no more than chattels such as horses, cows, etc., when men's labor is considered, economically, to be similar to the services of a horse.

\* \* \*

The distinction which it is necessary to make is between the *laborer* and his *labor*. A laborer is not a commodity unless he is a slave, but his labor is a "commodity," or more accurately, a service. It is different with a horse; its labor is a commodity, or service, but the horse itself is also a commodity which can be

bought and sold (as well as separate segments of the labor it can perform.) The whole horse can be sold, and naturally its labor power then goes with it; or a portion of the labor of the horse can be sold, as for a day, a week, a season.

In a free society, a man may not be sold like a horse. He therefore never sells his *total* labor. To do so would be to sell himself into what would be considered slavery. But a man does sell—should be prepared to sell—fragments of his labor. In other words, a *laborer* is not a commodity, but specific units of human *labor* are services to be priced as commodities are priced. It is—always will be—unfortunate to confuse a *laborer* and his *labor*.

What makes anything valuable? Something which we may call, using a term of Böhm-Bawerk, *renditions of service*.<sup>\*</sup> It will be helpful to compare a farm, a horse, and a man relative to "renditions of service."

Why is a farm valuable? Because it will contribute certain "renditions of service" in connection with producing foodstuffs. A farm has no *intrinsic* value in itself. Its value derives from the "services" it can provide, which services are wanted.

Why is a horse valuable? Because it, too, can perform certain services which contribute toward satisfying human needs. A beast capable of performing no services is valueless.

Why is a man valuable? A man is valuable to himself and others because he too can perform services which constitute renditions of service. Whenever he performs specific services for others he is in a position to exact pay for it.

It is necessary therefore to distinguish between *renditions of services* and the *bearer of those services*. What really counts is the renditions of services. These are sold (1) in fragments, or (2) in wholes, in the case of everything except human beings. When a man buys a horse or a farm, he buys *all* of the future renditions of service which these two can perform. Something which we call a commodity (and buy and sell as such) is really a bearer of renditions of services. This is as true of the inanimate as of the animate. It is the renditions of service which we are really buying and selling.

Rent paid by a tenant is for specific renditions of services by a house, the services of shelter, protection, privacy, etc. Such

<sup>\*</sup> This is the term employed by George D. Huncke, one translator of Böhm-Bawerk, for the latter's term, *nutzleistungen*.



rent is for a fraction of its potential total services, and is only for a night, month, year, or a specified time. Wages and salaries are "equivalent" to rent, that is, payment for services performed in a specific period of time or in a specific amount. The house is a commodity, a term intended to designate the whole package of potential services which something can perform. Similarly, a laborer would become a "commodity" if he sold his whole capacity to render services in one lump mass, by selling himself. Slavery can be defined as considering a human being who is the bearer of potential services as a package of renditions of services to be bought and sold as other "packages" of renditions of service can be bought and sold.

\* \* \*

The clarification of the proper distinction between renditions of services and the bearer of renditions of services was accomplished in the last half of the nineteenth century by the Neoclassicists of the Austrian school. That distinction, which they emphasized strongly, is essential for the solution of economic problems and the avoidance of fallacies.

It is significant to note wherein lies the quintessence of their distinction. It is this: instead of looking at the collective mass of renditions of service (embodied, for example, in a whole horse) only specific units of renditions of service are considered. The shift is away from a general or collective term, horse, to the services of a horse for plowing, or riding; and further not even plowing or riding generally but a specific amount of plowing or riding, such as pulling a plow to get ready a small patch of ground for a flower garden.

The tenor of the thinking in Neoclassical economics is away from the general to the specific. It was by that "method" that the Neoclassicists made their contribution to economics; it was by that method that they solved old confusions and unmasked long-accepted fallacies. The essence of the idea of marginal utility is to "get away from" *bread* as a general term and to consider instead a specific unit of bread.

That method, it will be evident to those familiar with the history of systematic human thought, is the same as that of William of Ockham (Occam), who put an end to the florescence of scholasticism by his method, known as Nominalism, which con-

sisted in considering what is specific rather than what is general. The modern age of science would not exist—could not have come into existence—except by the application of Occam's "approach." Marginal utility and Neoclassical economics are practical applications of Occam's method.

To argue "labor is not a commodity," is to look at "labor" as an *aggregate* mass of potential labor, or renditions of human services, embodied in a man, and then to say, really, that the whole laborer is not a commodity, which is correct. But *specific* renditions of service by a man, for which he gets a salary or a wage, are most certainly subject to the laws controlling the pricing of commodities and services.

### Potential "Injustice" To Employees; The Assumed Case Of Labor — One Buyer (The Employer) And Many Sellers (The Employees)

If specific units of labor should be priced, as was shown in the previous article, according to the same principle by which commodities are priced, is there any peculiarity which would put the laborer, when he sells his labor, at a disadvantage? To provide an answer it is necessary to take into account the attendant circumstances, in the framework of which the prices of labor (wages) are determined.

It will be remembered that Böhm-Bawerk had four categories, (1) isolated exchange; (2) one-sided competition among buyers; (3) one-sided competition among sellers, and (4) two-sided competition. As was evident from Chart I on page 358, the range in which the price can fall is different for these four cases: it is between \$100 and \$300 in isolated exchange; between \$280 and \$300 in one-sided competition among buyers; between \$100 and \$120 in one-sided competition among sellers; and between \$210 and \$215 in two-sided competition.\* If labor can have its prices set under Case 2—with one-sided competition among sellers of jobs—then its rate will be in the range of \$280 to \$300. But if the pricing of labor falls under Case 3, then the pay rate will be in the range of only \$100 to \$120. Case 3 consists of exchange with many sellers but only one buyer.

\* In the further discussion here of *wage rates*, the figures used by Böhm-Bawerk for *horses* will be used, because that will make the exposition proportionately simpler.

Under which case will the determination of labor's wages fall? The answer which *appears* appropriate is that the determination of wages is between *one* employer and *many* employees; then, apparently, the case falls under Case 3, one buyer of services and many sellers of services. Then the conclusion seemingly follows inescapably, that the determination of wage rates is rather disastrous for the employees. If we substitute monthly wages for men in the place of prices for a horse, then the price is most certainly at the low end for the laborer—only \$100 or \$120, because that is the price of a horse when there is one buyer and many sellers.

In order to make the case dramatic, it will be helpful to assume a town with an original population of 1,000, situated in a rural community in central South Dakota. That town existed in large part in order to be a shopping center for farmers. But there was added to that town a small company manufacturing elevators to be used in unloading grain from farm wagons into farmers' granaries. This company, let it be assumed, originated with one man, a blacksmith. He had designed a superior elevator and built it well, and consequently the business had grown. The blacksmith was now the president of the corporation and he had a payroll of 500. As a further consequence, the population of the town had grown to 3,000 people, of which 2,000 were dependent on the elevator company. Let it be assumed further that there was no other employer of consequence within a radius of 50 miles. If people in this town are to obtain employment (beyond jobs associated with the town being a shopping center for farmers), then there is only one place to go—the elevator company.

To whom does this *one* employer compare? Does he not compare with the lone buyer of a horse, with many anxious sellers? And do not the 500 employees, when they wish to sell their labor power—their potential renditions of service—find themselves in the position of the many sellers of horses, who *compete against themselves* (without the potential employer doing anything cruel or coercive)? And consequently, do they not find themselves pricing their services at the rate asked by the most urgent and weakest seller in the \$100 to \$120 range?

On first thought, some will conclude that they have here found a genuine confirmation of the hardship, if not the injustice, of the free determination of wages, when there is only one em-

ployer and many employes, or, at any rate, few employers and a whole multitude of employes. It appears that Böhm-Bawerk's detailed analytical approach has finally confirmed what had long been urged, to wit, that the bargaining for wages is "loaded against" or "stacked against" the employe. It will seem that all that an isolated employer needs to do in that isolated town in South Dakota is to sit back and let the workers drive down their wage by their own competitive offers. Could there, in fact, be a better reason for organizing a union, and presenting a solid union front—as of *one man—one seller* only of services—against the *one buyer*?

Further, considering what the range was in Case 1, the case of Isolated Exchange, namely from \$100 to \$300 (rather than \$100 to \$120 as we have been considering), would not the workers be foolish if they did not get a tough bargaining committee who immediately broke open the upper limit of \$120, and put the bargaining at a higher price level?

Such conclusions (which are however invalid) would most certainly be valid, if the case really fell under Böhm-Bawerk's Case 3. The fact is that the case only *seemingly* falls under Case 3.

It will be recalled that under Two-sided Competition the price (of horses) settled in a range of \$210 to \$215. In this case the range itself is small; the bargainers have only \$5 about which to argue. This contrasts with a range of \$100 to \$300, or an amount of \$200 about which to argue in isolated exchange, between one buyer (employer) and one seller (the labor union).

What might a labor union bargaining committee be expected to do? Get the wage rate close to \$300—maybe up to \$290—even though in a genuinely competitive market (two-sided exchange) the price would finally settle between \$210 and \$215?

Let it be assumed that the bargaining committee would be able to do that much—bargain the employer into paying \$290—instead (1) of \$120 which was *assumed* might be the rate of pay if there were many sellers but only one buyer; and instead (2) of \$210 to \$215, if there were many employers in the town competing with each other, and many employes also competing with each other (as is to be assumed under two-sided exchange). What will happen then? Workers in Sioux Falls, Sioux City,

Omaha, Fargo, Des Moines, St. Paul and elsewhere, would look at their own wage of \$210 to \$215, and some of them would eventually move to that isolated town in South Dakota and seek work there. There will be somebody, surely, who will undersell his services below the \$290 rate. The bargaining committee will not be able long to hold up the pay rate at \$290. In other words, this isolated town in South Dakota is not truly isolated. The term, isolated, can be no more than relative, because more workers *can*—and *will*—come into the town, if the prevailing rate is \$290 rather than \$210 to \$215.

But by similar reasoning, the employer is not an *isolated* employer (buyer of labor) either. In fact, if he pays only \$120, but 75 or 100 miles away in Sioux Falls or Sioux City the prevailing labor rate is \$210 to \$215, what will happen? The farm boys near the isolated town will work there long enough to "learn the trade" and then one by one they will move to where they can get the \$210 to \$215. The isolated employer will first have a heavy turnover of help, but finally the territory will be so drained of men that he cannot get enough men any more at the rate of \$120. He will be obliged, whether he wishes to or not, to increase his pay rates to approximately \$210 to \$215. In short, he is not an isolated employer, in a real sense.

There may, of course, be some differentials in pay between the isolated town of 3,000 people, and Sioux City, and Chicago, and New York. Such differentials may be *relatively* permanent. Cost of living is less in a small town; food costs are probably lower; transportation costs are certainly lower; there is less money required for entertainment simply because entertainment is not so elaborate in a country town as in Chicago or New York. The rates of pay in South Dakota may then be permanently under the pay in big cities, but only enough to compensate for the difference in the cost of living, or for other factors important to the laborers.

The idea that isolated exchange exists in well-established industries, or that one-sided exchanges exist, is untenable for another reason. The buyer in our case (the blacksmith who became president of the elevator company) is not the real buyer of the renditions of services by his employes. The apparent *single* buyer is not really such. He is only a "front man" or agent for a mul-

titude of buyers. The multitude of buyers are the farmers who buy elevators from this company (or another company). It is what the farmers will pay for elevators (a figure determined in its case by the marginal utility of elevators to farmers) that determines what the president of the elevator company can pay.

Similarly, the union bargaining committee is never more than a "front organization" or agent for the sellers of labor power. The bargaining committee must finally be as responsible to the men they represent, as the employer finds himself finally responsible to his customers.

### Four Kinds Of Coercion, And Their Relation To Justice

All four horizontal bars in Chart I on page 358 have an inner section designated "justice," and two outer sections designated "injustice."

It should be understood that there is no relationship between these designations and various popular ideas of a "just price," or vague ideas regarding what people *should* get, for one reason or another.

Some people consider a price to be just only if it covers all costs. There is no relationship between such an idea about a just price and the definition of a just price here used.

Others consider a price to be just only if it gives a "living wage" to those who participated in producing the good. This is another version of the "cost" theory referred to in the preceding paragraph. The getting of a living wage is, however, not something to be attained by pricing on a cost basis. A *living wage* depends ultimately on productivity. If productivity is not adequate for the so-called living wage, compulsory pricing designed to obtain it will be a delusion. (Although a living wage is not to be obtained by a "living wage" pricing policy, it can be obtained, however, as a by-product of free-market pricing.)

So-called just prices which look at prices from the producers' viewpoint are to be rejected as unsound. The only prices which can be just are those based on the viewpoint and evaluation of consumers. This is a case of *either/or*. Pricing must *finally* depend *either* on the wishes of consumers *or* on the wishes of producers. Under capitalism prices depend on *consumers*. Under collectivism

(socialism, communism, and to a degree in a "welfare state") prices depends on *producers* (enforced through the bureaucracy of government).

To be willing to let prices be determined by consumers is not to let a minority control prices. There are always more consumers than producers, because every person is a consumer, but not every one is a producer; consider children, the incapacitated and the aged, who all consume but do not produce. To let consumers control prices is to let the majority control prices.

In the view here held the consumer is sovereign; not the producer. But if the consumer is to be sovereign, he must not be coerced, because if he is coerced he is not sovereign any more.

The meaning of coercion can be so varied that a further explanation is in order of what is here meant by coercion and noncoercion. It is desirable to consider four kinds of coercion, which affect the affairs of men:

1. The coercion of natural (physical) laws.
2. Coercion which affects a man, because of action based on the self-interest of others. This includes *competition*, but is not limited to it.
3. Coercion in the form of violence, fraud or theft.
4. Coercion by legislation, by laws, regulations, etc. of the government, presumably representing the majority, but maybe representing congeries of minorities, operating together at the expense of helpless or, at least, nonparticipating minorities.

### Coercion From Natural Laws

Every participant in Böhm-Bawerk's two-sided exchange was under the "coercion" of physical laws. One of the sellers may have been hungry; he may have been *obliged* to sell a horse in order to have funds to buy food. Every participant was subject to the universal *welfare shortage* which affects (or afflicts, if that is the word which is unthankfully used) every member of the human race. There are *necessitous* buyers and sellers, that is people who are obliged by their circumstances—misfortune, sickness, folly, weakness, age — to buy or sell. They — we all — must "knuckle under" to the circumstances of life. There is no buying or selling which in some degree or other is not influenced by this "coercion." But coercion of this kind is not the coercion which causes a

resultant price to be unjust. This (1) "coercion" and (2) injustice are not relevant to each other.

### Coercion From Others Pursuing Their Legitimate Self-Interest

There is a second "coercion" which operates on all of us, but which does not (simply because it is coercion of a sort) invalidate a price and make it unjust. This "coercion" is the influence on our affairs which results from others pursuing their own interests. Suppose a man is a producer of horses. Suppose, too, that he has long enjoyed a good market. But then many others undertake to get into the horse business; then the market is glutted with horses; the business is no longer good. Again circumstances, in this case in the form of competition, affect — *coerce*, in a way — the activities of the original producer of horses. But no "injustice" has been done to him. The legitimate pursuit of others of their self-interest *as they see it* is not an act of injustice, and does not create an "unjust" price, even though the resulting price does not cover costs.

Usually, moralists do not look on fellow competitors as contributors to an unjust price; they do not look critically at the people on the same side of the market as the person whom they are considering, e.g., a buyer; instead they look at the people on the other side as the parties who might be guilty of creating an injustice, i.e., the sellers. If Böhm-Bawerk's analysis makes anything clear, it is the idea that men *on the same side of the market* can adversely affect the price as much as men on the opposite side of the market. But moralists usually limit their critique to the harsh buyers relative to the sellers; or the harsh sellers relative to the buyers; (it all depends where the moralists' sympathies lie). But critique of the parties on the other side of the bargaining table when prices are being determined is also invalid. If a man wishes to buy a horse, why should anyone be obligated to sell him a horse cheaply, or sell him a horse at all? Certainly, if there is to be freedom, neither buyers nor sellers are properly to be coerced to do what they do not wish to do.

The pursuit of legitimate self-interest by other people, on the same side or the opposite side of the bargaining table, are not really coercion. What "coercion" is here improperly taken to mean by those who criticize the operation of the free market is



factors beyond the control of an individual. True, the pursuit of self-regarding interests by others are not amenable to control by a particular person. But to fail-to-have-control-over-others is not equivalent to coercion by them.

### **Coercion By Violence, Fraud And Theft**

This is a *coercion* which constitutes *injustice*. This is the coercion that is forbidden in the Decalogue. This is the coercion of the wicked over the righteous; of the strong over the weak. This is the coercion which the statutes and courts of a well-ordered society will prohibit, or at least restrain.

However, such restraint (admirable as it is) is only supplementary. The best laws and the best courts *could* not function effectively alone against this evil coercion. Something more important than statutes, courts, judges and juries is needed for prices to be set noncoercively. (See the next article.)

### **Coercion By Legislation, By Laws, Regulations, Etc.**

*A* may by threats and violence be able to compel *B* to exchange with *A* on terms which are unjust for *B*. Presumably, the *law* will come into operation to restrain *A* and protect *B*. But it is possible to pass laws or to appoint bureaucrats who may exercise discretion which will permit *A* and others with him *who together constitute a majority* to force *B* to make exchanges unfavorable to himself. *A*, together with *C*, *D* and *E*, may pass a law which prohibits *B* from pursuing his legitimate self-interest in the form of planting more acres in corn or cotton; or *K*, *L*, *M*, *N*, *O* and *P* may pass a law setting a ceiling on the prices of corn and cotton. In these cases the intent of private coercion is effectuated through power based on a majority. This is simply violation of the Sixth Commandment against coercion under the lofty guise of *law* and *public will*.

When justice, in the present analysis, is made dependent on the nonexistence of coercion, "noncoercion" refers only to the categories (1) and (2), namely, physical laws, and competition (and other manifestations of legitimate self-interest). Contrarily, the coercion which is considered to be invalid is that designated under the categories (3) and (4) in the foregoing.

\* \* \*

The foregoing considers *justice* only. It does not consider alms or charity. Nevertheless, there appears to be a breach in the

situation. What about circumstances where one party to an exchange is desperate, a person whose plight is such that he has lost all his options, for example, a man who needs surgery for his life and who can pay only by selling something on short notice at a low price? What should a buyer do in such a case? Is everything to be cold-blooded and is a buyer to rub his hands in glee, and trade mercilessly at the expense of another?

Such cases arise. But they are fewer than estimated. When they do arise, the man who takes "undue advantage" of another's urgent needs is not well-regarded. Public opinion condemns him. He buys his unusual financial gains at the expense of his reputation. To be a pawnbroker is not to be in the most respected business, although to be a pawnbroker is no disgrace in itself.

But there is another side to the coin. If such an operator is really taking advantage *generally* of the unfortunate (and does not on the average have losses which require hard bargains in specific cases), then his profits will be inordinate. The business then will attract others; competition will lower the extraordinary profits to a normal level.

If then you see Johnson driving a merciless bargain with Brown, why not step in yourself and offer Brown something better, taking for yourself only what is an "ordinary return" and not exploitive of Brown. The best way to correct the hard bargains of others — from which they make extraordinary profits — is to compete with them. It is not meritorious to sneer at pawnbrokers; if pawnbrokers drive too hard bargains, the thing to do is to go into the pawnbroker business on a more considerate basis.

But you may discover that pawnbrokers must operate — on the average — as pawnbrokers do, or else you will lose money. If you nevertheless stay in the business and lose money, you are really making contributions to charity. You are no longer in an exchange business, but in an alms-giving business.

## How The Market Protects The Individual Trader

In a free market, with enough buyers and sellers so that there is two-sided exchange, is the inexperienced and nonpowerful seller or buyer *protected* reasonably against others — the powerful, the shrewd, the veterans?

That is an important question, because the customary assumption is that an inexperienced, uninformed, nonrich buyer or seller is at a grave disadvantage, and needs to be protected against others by a paternalistic bureaucrat. Such a buyer or seller is thought to be "on his own," unassisted by others, and consequently exploitable. Such an assumption has been shown to be invalid by the analysis earlier in this issue and in the two preceding issues. The true situation is worthy of a descriptive summary.

1. There are two marginal pairs. One of the pairs is the last to make an exchange; call them the first pair; see items marked (a) in Table I. The other is the first of the pairs not to make an exchange; call them the second pair; see items marked (b) in Table I. The first pair determines the participants. The second pair determines the range of prices, because the second pair has a price range within the first. In regard to actual trading, it is the first pair that is ultimate. In regard to price, it is the second pair that is ultimate.

2. In two-sided exchange, the individual buyer or seller does not set the price; the second marginal pair does. See pages 331-342. Everybody who makes an exchange, other than the excluded marginal pair, makes a good deal *for himself* by exchanging. Even the two members of the first marginal pair (Ae and Be) gain from the exchange; what they get is subjectively more valuable to them than that with which they part. But all the others who are in the pairs which have a still greater capability for exchange than the first marginal pair have an even bigger spread between their subjective valuations and the price range set by the second marginal pair. Those with large capability of exchange are big gainers, whereas the members of the first marginal pair are modest gainers.

Gains to individuals from exchanges are therefore never perfectly equal; (what is meant in this case by *gains* is the spread between the subjective value to a person of what he surrenders versus the subjective value to him of what he receives in place of it).

3. Those with still smaller capacity for exchange than the first marginal pair, simply are not willing to make a deal to which others will agree. They are outside of the market, but they hover on the edge, and when their valuation and that of others change, they may be able to participate.

4. The second marginal pair, whoever they *happen* to be, determine the price. That one would-be buyer and one would-be seller constitute the ultimate marginal pair in regard to price is not *their* doing. That the "lot" falls on them to be that marginal pair depends on how many others there are ahead of them in capability to exchange. If one of these drops out or another comes in, there will be a shift in the marginal pair.

Böhm-Bawerk is meticulous and detailed in regard to the marginal pairs in his exposition; see page 336. His explanation of the marginal pairs is complex. If the answer in regard to price determination is to be simplified, then it would read this way: *the marginal pair consists of the would-be buyer and the would-be seller who come the closest to making an exchange but fail.* The price will fall between the bid of that would-be buyer and the offering of that would-be seller. (In Böhm-Bawerk's illustration that buyer was *Af* bidding \$210 and that seller was *Bf* offering a horse at \$215.)

5. It is now possible to state a conclusion in genuinely two-sided exchanges of commodities or services, namely: an inexperienced or weak buyer or seller, provided he informs himself on what the market is:

(a) will not be able to buy or sell if his subjective evaluation is outside the range of the marginal pairs; he will not make an exchange, because he has priced himself one way or the other more demandingly than the real market; consequently, he cannot be "hurt" by others:

(b) he will be able to buy or sell advantageously to himself if he is not one of the second marginal pair determining price, but has a greater capacity of exchange than the members of that marginal pair. He will be getting a higher price if he is a seller, or paying a lower price if he is a buyer, than his subjective valuations indicated, and than he was actually willing to deal. He does not lose; he gains.

6. If he was too opinionated to heed what the higgling of the market revealed the valuations of the second marginal pair to be, he should blame himself. If he had ascertained what the market is, he needed only to make his own offer better than that of the second marginal pair (if his subjective valuations permitted

that), and then he would have made an exchange advantageous to himself.

Nothing in this world promotes justice more than the development of genuine two-sided exchanges in the "markets" of the world, for commodities and services. Competition in two-sided markets protect men far more than judges, bureaucrats or policemen.

## Relation Between Prosperity, Principles Of Morality, And Pricing

Natural Poverty Of Men

Safety Of Property A Prime Requisite To Prosperity

Exchange, As A Requisite To Prosperity

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In The Markets Of The Western World

More should be written about pricing, but the foregoing must suffice. A few remarks will be presented regarding the cause of poverty, the requisite foundation of prosperity, the beneficent effects of exchange, how exchange depends on *free-market pricing*, how socialism-communism cannot become world-wide as an economic system, how the backward nations must adopt free-market pricing if they wish to escape their economic backwardness, and how the free market pricing system is being undermined in the Western World by a deplorable policy of emitting fiduciary media.

Although understanding the free-market system as it has been explained in the foregoing is of great importance, the principles on which free-market pricing rest are of even greater importance.

### Natural Poverty Of Men

The Hebrew-Christian account of the origin of man makes clear that man was created *poor*. He was a wandering fruit, berry and nut picker. He was at once presented with the problem whether he would stay in that condition by refusing to recognize property rights; the fruit of one tree in the Garden of Eden was reserved from him. On test he refused to recognize property rights, and ate. By this act he disqualified himself from organizing a settled society, because in such a society property must be

safe. The alternative was to continue to be a wanderer subsisting off what grew naturally. That is a system that can survive without property rights. It is a system of "first come, first served," or a system of "finders are keepers." But it is the poorest and most precarious system for survival. That is what happened to Adam; he was driven out to be a wanderer.

### **Safety Of Property A Prime Requisite To Prosperity**

Although to be a gleaner of berry, fruit and nut trees and a hunter and fisher does not require strong property rights, to be a tiller of the soil does require it.

No society can have a good living until its members work to increase production by tillage, rather than glean what grows naturally. A man will not work to produce unless he expects to have a fairly sure claim to the results. Property rights are essential for a society based on tillage; (these rights may be for a tribe in some cases, rather than for an individual). If the remuneration of productive labor is in doubt, men will take to marauding rather than to working. Even primitive prosperity depends, therefore, on property rights.

The greater the amount of property that exists, the greater the need for property rights. The prime foundation under prosperity in the Western World is the existence there of a large amount of *capital per capita*. The lesser prosperity everywhere else in the world exists because there the capital per capita is less. Capital per capita is less there because property has been less safe there. Cause and effect are obviously operative in this situation.

### **Exchange, As A Requisite To Prosperity**

If men were berry pickers for centuries, and tillers of the soil with each family producing only for its own consumption for further centuries, the increase in savings and capital and the discovery of the benefits of specialization in production inevitably brought on a third era—the era of exchange.

The modern age is the acme of what men have been able to develop thus far in an exchange economy. By specialization, especially with the aid of capital (tools, power, etc.), production has been enormously increased in areas in which the Western Economic System prevails. Shoes are made today by mass meth-

ods; similarly bread, etc. But mass-produced shoes and bread, etc., must be *exchanged*. Exchange and prosperity are inseparable today.

### Pricing As The Crux Of Exchange

But when exchange became the basis of prosperity which was beyond what could be raised self-sufficiently on an isolated farm and consumed there, then the prices by which the exchanges were accomplished became of crucial importance. To "coerce" the prices in exchanges in its result was the same thing as marauding a settler's farm. In the one case, the marauder would merely wait until harvest; in the other, he would simply wait until the time when the price was to be determined. In an exchange economy, then, unless prices are "free," the right of ownership of property is effectually frustrated or "frustratable." To rob a man today it is not necessary to trespass on his property, beat him, and seize his goods; instead, merely force him to sell for less or buy for more. That is a suaver way to rob, and it is the way that it is being done.

### The Term, Right Of Property, As A Violation Of Occam's Razor

Right of ownership is not a special right, which the Decalogue failed to specify. Right of ownership is *implicit* in three of the Commandments against (1) coercion (the sixth), (2) theft (the eighth), (3) falsehood or fraud (the ninth).

It is legitimate to give one of the consequences inherit in those Commandments a new name, to wit, *right of property*, but the "right" is fully included in three Commandments themselves. Deny to men the right to coerce, steal and defraud, and you have thereby legislated private property.

In a sense, it is never necessary to use the term, right of property, or to appeal to that right. Omit the term entirely, as a violation of Occam's Razor, *Entia non sunt multiplicanda praeter necessitatem*. Instead, keep matters simple — mention only, insist only, on the three pertinent Commandments in the Decalogue. Save yourself the trouble of coining a new term, right of property, beyond the Commandments.

To understand the causal connection between the Commandments and the right of private property is tantamount to realizing that price controls are contrary to the Decalogue.

**The Socialist-Communist System Of Pricing  
Cannot Be Other Than Plagiarized (Copied)  
From Free Markets, And Cannot Become World Wide**

The Böhm-Bawerk exposition of price formation, presented in the foregoing issues, entails a clear understanding of simple but in some cases unfamiliar ideas: (1) marginal pairs, (2) marginal utility, (3) subjective value, (4) scarcity, (5) welfare shortage, (6) noncoercion (freedom), (7) nondeception (honesty). Value and price in this system depend on demand.

The socialist-communist system is different. It does not use these concepts, but has irrational and mystical thought categories contrary to fact. In simplest language, socialists-communists declare that value and price depend on costs.

*Can an economy be built on valuations based on costs?* The answer is, No. See the conclusive argument against the independent workability of the socialist-communist proposed price system in Ludwig von Mises's, *Socialism*, (Yale University Press, New Haven, Conn., 1951), pages 131ff. and elsewhere. Mises shows that if the *whole* world is organized on a socialist-communist basis, the world will then be devoid of the factual material necessary for economic calculation and planning.

Presently, socialist-communist political economies are plagiarizers — copiers — of prices set in free market countries. They may be unconscious plagiarizers, but their system, if independent and able to lean on nothing else, is unworkable.

**Backward Nations Must Adopt  
Free-Market Pricing**

The Free World, befuddled by fallacies, and confused by credit intricacies and dishonesties which have become incorporated in its monetary system, has lost virile faith in the unique merit and workability of price formation in a free market, *according to the Commandments in the Decalogue*. The Free World no longer "exports" the ideas on which its original welfare depended; it is itself carrying on only on the momentum of the institutions established by ancestors who did understand first principles.

But the backward nations cannot emerge from their plight unless they adopt the original principles of price formation on which the prosperity of the Western World has been built. The



backward nations cannot inherit or copy the welfare state from the Western World *directly*. They will first be obliged to establish a free market economy, and then their own welfare state can feed on that as a cancer on healthy tissue if they wish that.

### A Destructive Factor Presently Incorporated In The Markets Of The Western World

Finally, the just and intelligent system of price formation, based on rules set by the Decalogue, which has made the political economies dependent on it spectacularly prosperous, is being systematically undermined by the contra-Decalogue practice of issuing *fiduciary media*. If continued, this practice will create the *chaosification* of the capitalist world. The consequence will be a turn in desperation to strong men, tyrannies, and collectivisms. Modern men may, unfortunately, have to go through the deep valley of economic dark ages in order to recover their awareness of the validity of the Commandments against coercion, theft and fraud, just as the ancient classical world collapsed under the invasions of the barbarians from the north.

Regarding the phenomena of fiduciary media and its consequences, see Volume V, pages 97ff.

\* \* \*

Finally, principles of price formation are not mere technicalities of economics, but specific applications of general moral principles.

(In regard to future issues, see pages 353-4).

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