JOHN R. COMMONS
Selected Essays

Volume Two

Edited by
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JOHN R.COMMONS: SELECTED ESSAYS

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JOHN R.COMMONS: SELECTED ESSAYS

John R.Commons is one of the most significant figures in the development of American economics. One of the founders of the institutional school, Commons developed theories of the evolution of capitalism and of institutional change which continue to influence modern economics. These volumes collect, for the first time, his major essays and articles.

Malcolm Rutherford is a Professor of Economics at the University of Victoria, British Columbia, Canada. His research has focused on the major contributors to the American institutionalist tradition in economics, including Veblen, Commons, Mitchell and Ayres, and on the comparison of the old and new institutional economics. He is the author of *Institutions in Economics: The Old and the New Institutionalism*.

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HOBSON'S *ECONOMICS OF UNEMPLOYMENT*[1]

American Economic Review 13 (December 1923):638–647.

Economic theories may be placed in four groups according to the remedies proposed for unemployment and business depression, as follows: (1) reduction of wages, (2) reduction of profits, rent and interest, (3) free banking, and (4) bank regulation. Each of these proposed remedies goes back to one of four factors in the modern economic process which the particular group sets forth as its most important factor, though all of them are essential to the process. These factors are, in the order of the remedies mentioned: (1) the production and consumption of goods, (2) inequality of private ownership of the goods, (3) exchange and alienation of titles to the goods, and (4) the promises of banks and business men to deliver goods or pay an equivalent value in the future. Starting out with one of these factors as the most important, each group develops the implications of that factor and thus arrives at one of the four types of remedies.

The production and consumption group, with its remedy of wage reduction, begins with Ricardo, followed by the assemblage of those who find their explanations of business depressions in the natural or unavoidable operations of demand and supply under the influence of costs of production, and may be known as the classical, neo-classical, *laissez-faire,* or business economists.

The inequality-of-ownership group of theorists, with their remedy of reduction or elimination of the rents, profits, and interest that arise from inequalities of private property, have, as their outstanding economist, Karl Marx, followed by the entire socialistic school, the leading modern representative of which, from the standpoint of economic theory, is J.A.Hobson.

The exchange and alienation theories, with their remedy of free banking or paper money, based on a concept of money as a kind of transferable title to property like a warehouse certificate, start with Proudhon and the anarchists and find their recent representatives in Major Douglas,[2] Henry Ford and Thomas Edison, who adhere to private property with its inequalities, but find their explanation of business depression in the arbitrary restriction of the supply of money by a bank monopoly of credit.

The bank regulation group, with its remedies of stabilization of prices, proceeds from McLeod and Juglar in the decade of the 1850s, to Fisher, Cassel, Hawtrey and the more recent writers, Foster and Catchings,[3] who find their explanations in the discrepancies between the production and consumption of goods and the promises of business men and banks to pay the prices of those goods in the future.

It must be remembered that modern economic theory originated not so much in the work of Adam Smith as in the debates between Ricardo, Malthus and their friends, respecting the condition of England after the Napoleonic wars. It is in the letters of Ricardo to Malthus (1813 to 1823) and in the *Principles of Political Economy* by Malthus (1821) which is evidently the reply of Malthus to Ricardo, that the modern theories of economics and the corresponding remedies for trade depression find their origin. Much of their discussion turned on the measure of value, and, as pointed out by Wieser and Whitaker, they did not clearly distinguish between a measure of value and a cause of value. A measure of value is an arbitrary unit, hit upon by custom and standardized by law, having a divisible attribute similar to that of the thing to be measured. But a "cause" of value may be found either in the costs of production or the wants of consumption, and Ricardo took the former while Malthus took the latter.

Ricardo, by his process of averaging, found that the labor cost was the essential cost both of money, the measure, and of commodities, the things measured, and that the values resulting from the same cause moved on in substantially parallel lines. This being so, money could be eliminated from economic theory, as well as the wants of consumption which are incommensurable and insatiable, and economic theory could be satisfied with the relative labor costs of production of commodities.

By eliminating money he eliminated what, for Malthus, were the most essential phenomena, namely the *changes* in values of commodities occurring in disastrous periodic cycles. But Malthus, while criticizing this elimination of money, nevertheless himself practically eliminated it by picturing money as the symbol of demand and resolving it into the effective demand of property owners for the products of labor. Money became, for each of them, a merely nominal value, while the real value back of money was in the field of production and consumption.

Hence they reached opposite conclusions as to the remedies for unemployment and business depression, each, however, in the field of production and consumption. Ricardo attributed the depression following the Napoleonic wars to the obstinate refusal of wage-earners to accept a reduction of real wages, which refusal made it impossible for employers to hire them and make a profit at the reduced exchange values then current for the products of labor.[4] But Malthus attributed the depression to the refusal of property owners and governments to employ laborers on "unproductive" work; that is, upon work that did not come upon the competitive markets where it would reduce prices. For him, the depression was owing to the excessive stimulus previously given to production of competitive products, and this could be remedied or prevented only by such "unproductive" consumption as taxation for public highways and other public works and the "unproductive" consumption of landlords and wealthy people in the improvement of their estates and the employment of "menial" servants.

Ricardo was greatly alarmed at Malthus's proposal to increase taxes at the very time when business was depressed, and it will be seen that his remedy, the reduction of wages in order to stimulate profits, was exactly the opposite of Malthus's remedy, an increase in the demand for labor in order to stimulate consumption.

It was inevitable that, in course of time, the Malthusian remedy should take a different turn when expounded by spokesmen of the laborers. If unproductive consumption depended upon the will of property owners and governments it was a hopeless expedient. But if the laborers themselves became both property owners and government, then they

could employ their resources directly in consumption and thus maintain the demand for labor. This was the turn taken by Marx whose use of the Ricardian theory of value was simply a metaphysical dress for a plan of substituting control of consumption by laborers for Malthus's control of consumption by governments and property owners. While, with Malthus, depressions were owing to overproduction and underconsumption by both property owners and governments, with Marx they were owing to overproduction by property owners and underconsumption by laborers.

The modern representative of this view, eliminating the superfluous and untenable Ricardo-Marxian theory of value, is J.A.Hobson in his *Economics of Unemployment*. He starts with the idea of "a limited market," or lack of demand, common to all theories. His argument, differing from that of Marx, turns on the periodicity, or cyclical occurrence, of depression and unemployment. He rejects or minimizes the effects both of wars which merely dramatize the cycle (p. 15) and of credit which merely anticipates the expected failure of effective demand (p. 27). The key of the explanation is the failure of consumption. "The orthodox economist [that is, the Ricardian economist] is convinced that overproduction is impossible and that underconsumption is equally absurd." The economist confines his attention to the "stoppage of industry, which he rightly diagnoses as underproduction…. But this state is the product of an excessive activity preceding it. Overproduction, congestion, stoppage, is the visible order of events" (pp. 31, 32).

The question, then, is "Why does consumption fail to keep pace with increased powers of production? Or, conversely, "Why do the powers of production increase faster than the rate of consumption?" (p. 32). The explanation is "the normal tendency to save a larger proportion of income than can effectively and continuously function as capital" (p. 35). This is due to "conservatism in the arts of consumption" and "inequalities in the distribution of income." The income of the wealthy is greater than they can consume, according to their standards. So far the explanation is exactly Malthusian. The next sentence makes it Marxian: "Any approximation towards equality of incomes would reduce the proportion of income saved to income spent" (p. 37).

Mr. Hobson hastens to explain that by oversaving he means "solely the proportion of saving to spending," and not "any fixed limit to the amount that can be serviceably saved" (p. 37). And he then contrasts what may be distinguished as the space and time dimensions of the economic proportioning of factors:

> Just as waste of productive power admittedly occurs by misapplication of capital, skill, and labor, as between one trade and another, or one area of investment and another (too much applied here, too little there), so income as a whole may be wastefully applied as between purchase of commodities and purchase of new capital goods…. In other words, consumption is the final link in a chain of economic processes, each of which should be kept in accurate proportion to the preceding ones, unless stoppage and waste are to occur.
>
> (pp. 37, 38)

The "orthodox economist" objects that "the natural result of a process of equalization of incomes" would be "undersaving," in the sense of "a refusal to save enough to realize the enlargements and improvements of the machinery of production that are required to

furnish a larger output of commodities for a higher standard of a growing population." He meets this objection by distinguishing between a large proportion of a small income and a small proportion of a large income. The total national income would be greatly increased if labor and capital were continuously employed.

> Under such circumstances, although a smaller proportion of the larger income might be saved, and a larger proportion consumed, the actual amount of saving might be as large as or even larger than before, and, being more fully utilized as capital, might maintain as high a rate of economic progress as before.
>
> (p. 40)

The solution, then, resolves itself to this: equalization of incomes will have a double effect—it will increase the total production by keeping labor and capital continuously and fully employed, and it will maintain an accurate proportion between saving for future consumption and spending for present consumption, so that there will be neither oversaving nor undersaving.

Evidently Hobson has stated correctly what is wanted and what is agreed to by all of the four types of theorists, namely, continuous full employment and not too much nor too little saving. The question turns not only on the remedy of equalization of incomes, but especially upon the mechanism by means of which the remedy will operate. Karl Marx and Lenin provided definitely a mechanism. If the state takes over the management of all industry, thereby fixing wages, prices and jobs, evidently it can perform the process of "saving" by merely detailing a certain proportion of laborers to the production of machinery, buildings, railroads, and so on, another proportion to the production of raw material and manufactured goods, another proportion to the wholesaling and storage of goods, another proportion to the retailing of goods. This mechanism would doubtless break down under democratic control, but might continue under a successful dictatorship.

Hobson's mechanism also calls for a thoroughgoing action of government in all lines of industry: an obligatory minimum wage in all employments, government ownership or at least control of wages, prices and other conditions, and taxation of surplus earnings (p. 115). These governmental remedies, we may agree, are advisable, in so far as practicable, as remedies for the inequalities of income, but not for the kind of oversaving that grows out of the fluctuations of prosperity and depression.

The present methods of capitalism provide a definite mechanism for savings, not dependent upon the will of individuals or wisdom of governments. Henry Ford, the Standard Oil Company, the U. S. Steel Corporation and others large and small, build up the equipment of industry out of the margin between the costs of labor and the prices charged to consumers. It is, indeed, a kind of dictatorship, through private property, in that it is effective because the laborers and consumers have no voice in raising wages and reducing prices. When the government starts in to dictate wages and prices, the railroads, for example, have great difficulty in obtaining enough capital for extensions. Savings are very largely a matter of wage and price fixing and there is a capitalistic mechanism based on private property and dominated by competition and fear of bankruptcy that practically forces savings to be made. However badly the mechanism works, it is an automatic mechanism that does not depend either upon the wisdom of government or upon

admonitions as to how or how much a person ought or ought not to save or spend his income after he gets it, in order to furnish continuous employment by not oversaving or undersaving. The mechanism actually fixes his income before he gets it, and one of the factors in the mechanism that fixes that income is the necessity and foresight of saving for extensions, improvement of plant and insurance against accident, contingencies, loss of markets, fluctuations in prices, and bankruptcy. Saving is not optional; it is compelled in order successfully to work the mechanism of private property.

Yet Hobson's criticism of the complacent arguments which the business economists used in denying any possibility of evil in the capitalistic mechan-ism of saving is sound. Oversaving, they said, was impossible, because any tendency to it was corrected by a falling rate of interest; and overproduction was impossible because any tendency to it was corrected by a fall of prices stimulating increased consumption. Admitting these checks, replies Hobson, they are too slow in their operation was a preventive of overproduction and gluts. This is because new capital added each year is such a small fraction of the total capital—only 5–6 percent—and because a change in the rate of interest does not affect materially the inducement to save even that small fraction (pp. 51, 52).

It certainly also can be said that Hobson's governmental remedies of minimum wage, price fixing and taxation are too slow to prevent overproduction and gluts.

But Hobson's principal criticism of the business economists is that their remedy of reduction of wages in time of depression overlooks the preceding lag of wages in time of prosperity. And it is in this preceding lag of wages that Hobson finds both the incapacity of consumers to purchase products and the oversaving and overconstruction of plant by capitalists which makes "towards a rate of production visibly greater than is able to find a profitable market" (p. 68).

It is by introducing this modern notion of "wage-lag" that Hobson separates himself from both the Malthusian and the Marxian as well as the business explanation of depressions. The early socialist, anarchist, and classical explanations had no concept of a business cycle, an outstanding feature of which is the wage-lag. They did not distinguish between a cycle and a panic, or between a "trend" and a cycle. They pictured a crisis as an event accompanying a period of falling prices, owing to reduced costs of production through technical improvements, and the panic, or crisis, occurred therefore as a more dramatic slump in a downward trend of prices.[5] This, we now know, is not the correct picture. The crisis occurs at the culmination of an upward movement, and, since the period of bank reform of 1844 in England and 1913 in America, the panic-and-crisis feature has been eliminated so that the cycle stands out more clearly than it did. Hobson has the correct picture of the cycle, which preceding socialistic, anarchistic, and capitalistic theories did not have.

But this picture nullifies at once the theory of inequality of incomes as the "cause" of the depression or cycle. The inequality now becomes a *result* of rising prices and wage-lag, not of private property. It is "inequality," indeed, but it is a different kind of inequality. It is a periodic inequality rather than what Hobson would call the "normal" inequality of private property. If the general level of prices could conceivably be stabilized by banking and currency reform, then this kind of inequality would not occur at all. There would be no periodic rise of prices and no periodic wage-lag. The other kind of inequality—"normal inequality"—would continue.

This double meaning of "inequality" is really a confusion of the concept of "wealth and poverty" with that of "prosperity and depression." Wealth and poverty pertain to the *distribution* of existing income between classes and industries. Some are wealthy, others poverty-stricken. But "prosperity and depression" pertain to a fluctuating process over a period of time. At one time both the rich and the poor are fully employed—at another time both rich and poor are unemployed. There might conceivably be the greatest extremes of wealth and poverty, as in the case of the slave-holding states or of Germany at the present time, but no cycles of prosperity and depression. Everybody might be fully employed and business continuously profitable, and yet accompanied by the greatest conceivable inequality of incomes. And, conversely, there might conceivably be perfect equality of incomes accompanied by cycles of prosperity and depression, that is, of full employment and unemployment. This certainly would occur with Hobson's slow-acting governmental regulation of wages and prices and taxation of surplus incomes. Equalization of incomes is advisable for other reasons, but not as a remedy for cycles of prosperity and depression.

This brings us to the two other groups of remedies and theories, the alienation-of-title group and the bank-regulation group. Hobson devotes a chapter to each. The alienation-of-title group, in its modern form, is represented by Major Douglas. Its remedy has always been a large supply of money, issued, not by banks in the ordinary sense, but by the producers of commodities themselves, and then certified either by a mutual association of producers, as Proudhon proposed, or by an equivalent issue of government money, as Peter Cooper, the Greenbackers, and Thomas Edison proposed. Its theory is practically that of a warehouse-certificate concept of money whose transfer alienates the property, instead of an exchange-value concept of money whose expenditure purchases the property.

Hobson agrees with Douglas, as indeed all groups agree, on "the failure of consumption, or effective demand, to keep pace with potential and actual consumption" (p. 119). But Douglas finds this failure in the refusal of those in possession of monetary power to purchase consumable goods because they prefer to apply it to buying non-consumable, that is, capital goods. This is a version of the doctrine of Proudhon and the paper-money theorists that there is not enough money in circulation to purchase the quantity of goods produced or producible by the existing amount of capital equipment. Douglas gives to the theory a novel turn by his analysis of costs in relation to the credit system. The money representing costs of production has been already spent as wages, salaries and dividends at the time of production, leaving only a small fraction to purchase the commodities themselves at the later date when they come on the market in consumable form. Douglas thus explains the lack of money in hands of consumers by the fact that bankers make their advances, not to consumers, but to manufacturers on factory account, overhead charges, purchase of raw material, wages, etc. They do not finance consumption—they finance production.

This is readily answered by Hobson in showing that it is not the wages paid for producing a particular commodity or in paying for its overhead, raw material, etc., that are used in purchasing that same commodity afterwards, but that it is the wages currently paid to other producers of other commodities. If all industries are moving on continuously, then, of course, the producers of machinery and buildings are purchasing the finished products of the producers of clothing and food. The defect is not in a

disproportion of money to production and consumption, but in the disproportion of consumption to production through the lag of wages. There is money enough available for the actual process of production and consumption—the difficulty is in the process itself.

It is significant that Hobson does not criticize Douglas on the weak part of the anarchist and paper-money analysis, namely, its concept of money as a kind of warehouse certificate whose supply should not depend on gold or bank monopoly, but should be increased in similar proportion to the increased physical quantity of commodities. This is evidently because Hobson looks on fluctuations of prices mainly as a result of inequality of incomes and therefore overlooks the rise of prices that would accompany the Douglas plan. He agrees with Douglas on the "dangerous power" of the banks in calling in their money and refusing advances and thus stopping trade and causing unemployment and underproduction (p. 126), but he does not consider the preceding over-advances of credit with rising prices as an equally "dangerous power."

It is characteristic of Hobson and the school that bases its explanation on the distribution of wealth that the modern banking system is significant, not as an appreciable factor in business cycles, but only as a new and large factor in the distribution of wealth and poverty (p. 108 *passim*). The "misuses and excesses" of commercial credit "exaggerate" the cyclical fluctuations, but the "normal" use of bank credit has little or no effect on the cycle. This was also the view of the classical economists. It is with Hobson again the lag of wages behind prices that is paramount, and hence the characteristic feature of bank credit, the changing ratio of bank credit to bank reserves, receives no mention whatever.

In contrast with Hobson may be set forth the recent book on *Money* by Foster and Catchings, representing the up-to-date theories of the bank-regulation group. I shall only briefly mention their main lines of argument without attempting to state the qualifications or cautions which they introduce. The earlier bank-regulation remedies of Juglar, McLeod and their followers attributed crises and depressions to the "misuse and excesses" of bank credit, just as Hobson attributes their "exaggeration" to that source. But Foster and Catchings attribute the cycle to the normal operation of bank credit. Money, with them, is the center of economic theory, instead of an afterthought, and they substantially agree with Hawtrey that the trade cycle is a purely monetary phenomenon (p. 12). After a brief discussion of the several functions of money (including bank credit), they settle upon the distinction between a "measure" of value and a "standard" of value, the latter being the central idea of the book. "When money is on a gold basis, it is a standard of purchasing power for one commodity and only one. As long as the gold basis is adequate, the power of money to purchase gold does not change. This is an advantage to dentists and goldsmiths…for the purchasing of gold. But not for anything else" (p. 43). "A gold basis evidently does not stabilize the purchasing power of the superstructure of paper certificate and bank credit" (p. 46). Yet the preservation of the gold standard is essential. Only by admitting its instability as a standard of value and thus correcting the instability as far as possible, can sound money be preserved against the attacks of Douglas, Ford, and Edison (p. 52 *passim*).

Here, then we return to the discussion of Ricardo and Malthus as to the proper measure of value. They debated whether the labor embodied in commodities or the labor commanded in exchange for commodities was a preferable standard of value. Now it is

discovered that the index number of prices is the proper standard of value. The whole question of prosperity and depression turns out to be located in the field of mensuration, and not in that of production, consumption, private ownership or bank monopoly. Governments have not yet adopted a standard uniform measure of value, the index number of prices, for the guidance of banks in issuing and withholding credit. Hence the volume of money, that is, bank credit, does not exactly correspond to the volume of trade, resulting in a general rise of prices by an oversupply of credit, followed by a general fall of prices when the reserve ratio has reached its limit of safety.

In line with this modern view of the bank-regulation group, most of the phenomena of overexpansion, oversaving, contraction and underconsumption can be explained by the instability of the existing measure of value. Indeed, a new meaning of the word "saving" itself comes into view. The oversaving is the result of the rising prices that ensue from an unstable measure of value. While prices are rising because the standard of value is shrinking, business men stock up with inventory and enlarge their plant in order to anticipate the higher prices. When prices are falling, they unload. Oversaving now becomes periodic rather than "normal," as pictured by Marx and Hobson. It is practically forced upon business men in order to meet the rising prices caused by an unstable unit of measurement. This is "saving," indeed, according to the economic definition of saving as the purchase of plant and inventory instead of consumption goods, but it proceeds from rising prices and bank credit rather than from a normal or permanent inequality of income. Not only does the wage-lag permit it, but all lags of prices are of its essence. To name it "oversaving" as Hobson does, is again to confuse the phenomena of wealth and poverty with those of prosperity and depression. It is more properly compulsory overspeculation upon an unstable measure of value than oversaving upon inequalities of income.

NOTES

1 J.A.Hobson, *The Economics of Unemployment* (Macmillan Company, 1923). Page references in parentheses, unless otherwise designated, refer to this volume.

2 C.H.Douglas, *Economic Democracy* (1920).

3 W.T.Foster and Waddill Catchings, *Money* (1923).

4 Letter to Malthus, July 21, 1821.

5 Cf. Commons, McCracken and Zeuch, "Secular Trends and Business Cycles," *Review of Economic Statistics,* October, 1922, pp. 8 ff.

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THE DELIVERED PRICE PRACTICE IN THE STEEL MARKET

American Economic Review 14 (September 1924):505–519.

Before the Pittsburgh-plus practice was adopted by the steel mills, steel was sold on a Pittsburgh zone-plus system. The country was divided into arbitrary freight zones with Pittsburgh as the center; each zone had a flat zone-price, identical for all delivery points within that zone; this zone-price of steel stepped up like a stairway by an arbitrary differential of two or three dollars according to the distance of that zone from Pittsburgh. A consumer of steel at Minneapolis, for example, could not purchase steel at the Chicago mills and then pay the actual freight from Chicago to his point of delivery, but could only purchase his Chicago steel at a delivered price set for the zone to which it was shipped, and that delivered price was the Pittsburgh price plus the stairway freight to the zone of delivery.

A large consumer of steel at Minneapolis proceeded to break the zone system. He bought a heavy consignment of steel to be delivered at a station in the Wisconsin zone at $1.00 per ton less than the delivered price in the Minnesota zone. This point of delivery in the Wisconsin zone had but one railway and that railway went through to Minneapolis. The freight rate, however, on that railway was the same to Minneapolis as it was to the Wisconsin way station. This Minneapolis consumer then made an arrangement with the railway company that the steel should not be laid off at the Wisconsin station but should be carried through to Minneapolis. In this way he got the Wisconsin zone price of steel instead of the Minnesota zone price and saved something like $5,000 on a single consignment of steel. The steel company found out about it, and put Wisconsin in the Minnesota zone. Then he repeated the trick at another similar point on the Michigan peninsula and saved another $5,000. Then the steel company sent a man to find out what might be the great manufacturing industries which this enterprising Minneapolis consumer was setting up in the Michigan peninsula. He discovered a couple of way stations and found that it was not a great expansion of Minneapolis over into Wisconsin and Michigan, but was merely a hole in the zone system of pricing steel.

So the steel companies proceeded to adjust themselves to that hole. They could not change the freight-rate schedules of the railways, so they fitted their delivery prices of steel to the freight rates. This is the Pittsburgh-plus practice. The zone system was abandoned and the delivered price of steel was computed at the Pittsburgh price plus the

exact freight, instead of the average zone freight from Pittsburgh to point of delivery. Now a purchaser of steel located at Minneapolis, Milwaukee, or elsewhere, while the Pittsburgh-plus practice is in vogue, cannot go to Chicago or Duluth and obtain legal control of steel there and then ship it to any place that he pleases, but he can buy that Chicago or Duluth steel only at a price which includes the freight from Pittsburgh to the point where the purchaser's factory is actually located. There is no hole left in the system. Each buyer of steel is shut up in his own little coop where his factory is located, since he does not get absolute title and full control of the steel until it is delivered at his factory. The steel companies sell the steel to him but they do not sell it at their mills. In addition to manufacturing and selling steel they also buy and sell freight and they require him to buy that freight from them instead of buying it from the railway companies.

When the Pittsburgh-plus practice was attacked before the Federal Trade Commission by the Western Consumers of Rolled Steel Products, on the ground that it was discriminatory and suppressed competition, the Steel Corporation set up the defense that the alleged discriminations were not really discriminatory at all, but were the natural result of the great law of supply and demand. Their answer to the complaint asserted that when they changed to the Pittsburgh-plus practice they were obeying the law of supply and demand, a law which they had been violating when they practised the former zone system. The issue in the case, then, turns on the question: how does the law of demand and supply actually operate in a free and equal market, and does the Pittsburgh-plus practice conform to or interfere with the free operation of supply and demand?

There are certain other facts regarding the steel market which should be stated in order to appreciate the Pittsburgh-plus practice. Within the past thirty years rolled steel has become almost as important as railways. Every skyscraper, every factory building is a rolled-steel product. Every automobile, every farm implement, every railway, every bridge is made of rolled steel. The consumers of rolled steel include almost the entire list of machinery manufacturers and building and bridge erectors. It is the age of steel, and a war is won or lost by the steel mills. In this tremendous industry two things have been found to be quite necessary, or, at least, highly useful, namely, standardization of products and stabilization of prices.

Rolled steel products have been remarkably standardized and these standards are perfectly known in the trade, including chemical content, shapes, sizes, weights and extras. When you order rolled steel, it is about as simple and accurate a process as ordering postage stamps. And you can order exactly the same specified product from any mill in the country that is equipped to produce it. Hence there is practically no competition as to the physical qualities of rolled steel. Every producer of steel knows, through the standardized specifications, exactly what it is that his competitor is selling, and he cannot pull a customer away from his competitor by offering a better quality. The only competition is in the price, the speed of delivery and the arts of salesmanship.

In the second place, the manufacture of steel is concentrated in a few large mills, each specialized to a certain kind of product, and many of these formerly competing mills are owned by one company, the United States Steel Corporation, producing 40–80 percent of the various kinds of products and owning plants strategically placed at Pittsburgh, Chicago, Duluth and Birmingham. This concentration of ownership came about twenty-five years ago, following the destructive and cut-throat competition of the former era when Andrew Carnegie dominated steel. That had been a period of violent and extreme

fluctuations in price, and of ruthless destruction or absorption of the weak competitors by Carnegie, alternating with short periods of illegal pools, combines or other price-fixing agreements. But the Steel Corporation has followed a different policy. Its great contribution may be summarized in the word—*stabilization*. Not that it has accomplished actual stabilization of prices, but it has resisted violent fluctuations, and has protected its customers against the losses formerly occasioned by unexpected boosts or unexpected slumps in prices. For this reason the policy of the Steel Corporation has been highly appreciated by the consumers of rolled-steel products as well as by the smaller competitors of the corporation. It has not attempted to drive the latter out of business provided they did not attempt to cut prices, but were content to limit themselves, in pulling customers away from the Steel Corporation, to the allurements of salesmanship and prompt delivery at higher prices. Whenever they started to cut prices, which they sometimes did in hard times, a gentle growl from Judge Gary, chairman of the Steel Corporation, uttered in the presence of newspaper reporters and published in the daily press and trade papers, served quickly to bring the price-cutters back to the announced prices of the Steel Corporation. It was this so-called live-and-let-live policy of the Steel Corporation, in contrast to the kill-and-eat policy of Carnegie, that saved the company from dissolution at the hands of the Supreme Court in the year 1919, when the government had attacked it as a conspiracy under the Sherman Anti-trust act.[1] The Steel Corporation, it was held by the court, does not violate the anti-trust laws when it merely announces publicly the prices it will charge for rolled steel, even though the announcement contains a well-understood intimation of what the company will do to competitors if they cut the prices too much.

The result is that, through standardization of products and stabilization of prices, all steel producers charge the same prices at the same dates (allowing for a little lag when prices are moving up or moving down) and they restrain their competitive zeal to the arts of salesmanship and prompt delivery. Price competition has practically disappeared, and this disappearance is held by the court not to be a violation of the anti-trust laws, since the salesmen continue to compete for business.

It will be seen at once that the Pittsburgh-plus practice fits in admirably with the standardization and stabilization practices. When the Steel Corporation announces publicly its price at Pittsburgh, every competitor and every purchaser, when the practice is in force, knows at once what its delivered price will be at every point of consumption in the United States. This knowledge is facilitated by a freight-rate book, published by one of the subsidiary companies of the corporation, giving the actual freight rates from Pittsburgh to all consuming points in the United States. If the company announces $40.00 per ton at Pittsburgh, for example, everybody in the steel trade knows at once that the delivered price at Chicago is $47.60; at Milwaukee is $48.30; at Minneapolis is $53.20; at Indianapolis is $46.90; and so on, no matter whether the steel is actually manufactured at Pittsburgh, Chicago, Duluth or Sparrows Point.[2] Hence standardization of product, stabilization of prices, and a single basing point at Pittsburgh are the most simple and perfect combination of trade practices ever yet devised by competitors for getting by the Supreme Court and maintaining uniform prices throughout the United States without violating the Sherman anti-trust law. This is uniformity by publicity and due regard for consequences, instead of the old-fashioned uniformity by secrecy and conspiracy.

It is also a perfect combination of trade practices for keeping the *immediate* consumers of rolled steel satisfied. Standardization of products and stabilization of prices are two things which the purchasers of steel want in order to shift the price of steel over to the *ultimate* consumers, the general public, which buys from them the machinery, farm implements, automobiles, skyscrapers, bridges, and the thousand articles ultimately made of rolled steel. If the prices of steel are uniform at the same time, and if they are stabilized for a period of time, and if this uniformity and stabilization, are well known to all immediate consumers of rolled steel, then all of them can know exactly what their competitors are paying for steel and can guess pretty closely the lowest price which those competitors will charge the general public for the ultimate fabrication and manufacture of products out of steel. Hence uniformity of prices through standardization, stabilization and publicity gets by the Supreme Court, satisfies the immediate consumers, and soaks the ultimate consumers.

And yet there is a big and curious element of secrecy about the Pittsburgh-plus practice. This will be discovered by noticing the circumstances which revealed the secret to the western consumers of rolled steel. The Pittsburgh-plus practice had been generally in vogue for practically the entire period after the formation of the United States Steel Corporation in 1901. Yet no material complaint was ever heard, though there was an expectation in certain quarters that the practice would disappear in 1908 when the Steel Corporation was completing its huge modern plant at Gary, Indiana, in the Chicago district. The practice, however, did not disappear, and everybody continued to be satisfied with the stabilization policy. Then it happened, during the war, that the War Industries Board ordered the practice to be discontinued and Chicago was made a basing point for the steel actually manufactured at Chicago. This brought the price at Chicago down to the same level as the price at Pittsburgh. But, after nine months, the War Industries Board, for some reason, ordered the Pittsburgh-plus practice to be restored. This was the first revelation of the secret. The second came when the Interstate Commerce Commission authorized freight rates to be almost doubled in 1920 above the level of 1914. This approximate doubling of freight rates, of course, made the discrepancy between the Pittsburgh base price and the delivered price substantially twice as great as before, and placed the western manufacturers and fabricators at practically double the former disadvantage in competition with Pittsburgh manufacturers and fabricators. This was the second revelation of the secret, and the immediate consumers of steel learned their lesson in the school of experience, instead of the school of economic theory. They did not think it out as academic economists do—they felt it actually hit them in the pocketbook. And so they proceeded at once to organize the Western Association of Rolled Steel Consumers for Opposing the Practice of Pittsburgh-plus and brought their complaint before the Federal Trade Commission. After the suit was commenced the steel companies voluntarily abandoned, in part, the practice for the Chicago mills and placed the price of some of the Chicago-made steel on a Chicago base plus freight from Chicago. Then, this association of immediate consumers, having obtained in part what it wanted, the general public, through the legislatures of the four states, Illinois, Wisconsin, Minnesota and Iowa, took up the case, and now thirty-two states through their legislatures, governors, or attorneys-general, are united in an Association of Ultimate Consumers opposed to Pittsburgh-plus.

What, then, is this concealed discrimination which the consumers of steel did not discover until the government, through the War Industries Board and the Commerce Commission, abolished it and then restored it, and then doubled it?

If all the steel, or the great bulk of the steel, were actually made in Pittsburgh and actually shipped from Pittsburgh, as was perhaps the case twenty and thirty years ago, then the buyers at points remote from Pittsburgh could have no just complaint on the ground of discrimination if they were compelled to pay 20–40 percent more for steel delivered at their location than the buyers who took delivery at Pittsburgh. In fact, like many discriminations in other fields, this one may be said to have grown up almost naturally, and can be explained on historical grounds. But for the past ten to fifteen years Chicago, Duluth and Birmingham have become large producers of steel, at even lower costs of manufacture than the costs at Pittsburgh. Using the figures given out by Judge Gary at Duluth in 1918, a computation shows that if we place the average operating cost at Pittsburgh at a figure represented by 100, then the cost of manufacturing steel at Duluth was 113, at Chicago was 80, at Birmingham was 81. But the delivered price at Duluth (on a basis of $40.00 at Pittsburgh) would be represented by 133 instead of 113, at Chicago by 119 instead of 80, and at Birmingham by 112 instead of 81.[3]

Why should not the buyers of steel at these various localities have been able to buy at even less than the Pittsburgh base price, when the steel was actually made at Chicago or Birmingham, or at considerably less than the delivered price when actually made at Duluth? And furthermore, why could not the buyer at Milwaukee or Minneapolis or St Louis have bought the steel at the Chicago or Birmingham or Duluth price, and then have paid only the actual freight from these points, much less than the computed freight from Pittsburgh? The curious fact impressed itself upon the consumers that steel actually made at Chicago was sold as though it were made at Pittsburgh, and then the freight that was added was not the actual freight from Chicago but the imaginary freight from Pittsburgh. The Milwaukee purchaser, for example, bought actual steel actually made at Chicago and carried on actual freight trains from Chicago to Milwaukee, but he seemed to be paying a price for fictitious steel made at fictitious Pittsburgh mills and carried on fictitious freight trains from Pittsburgh to Milwaukee. It was this seeming discrepancy between the actual cost and the fictitious cost of both steel and freight that the consumers pointed out and made the ground of their complaint of discrimination before the Federal Trade Commission.

The Steel Corporation made its answer to the charge of discrimination by asserting that Pittsburgh was the point of surplus production of steel, whereas Chicago and other points did not produce enough to satisfy their local demands; therefore, the Pittsburgh price plus freight was the natural price determined by supply and demand. They also contended that each point of delivery, and not the point of production, is a separate market for steel; that all producers of steel compete equally and freely at each of those delivery points; that the Steel Corporation charges the prices thus determined by the free competition of steel producers at those delivery points, and therefore the resulting discriminations in price were not really discriminations in the eye of the law, because they were justified by the higher law of supply and demand to which the steel company was compelled to submit in meeting competition.

In reply to this defense, the economists who appeared as witnesses on behalf of the four states[4] set up what they contended was the true definition of a free and equal market.

They contended that even though the *producers* of steel might be competing with each other at the points of delivery, yet this delivered price practice prevented the *consumers* of steel from competing with each other at the points of manufacture; and that it was this inability of consumers to compete with other consumers at the points of manufacture that was the source of the discriminations.

The fact on which they based their analysis of the Pittsburgh-plus market for steel may be illustrated as follows. If the Pittsburgh mills are selling steel at $40.00 per ton and the freight from Pittsburgh to Chicago is $7.60 per ton (figures for 1920), then the Chicago mills are selling their own steel in the Chicago district at $47.60 per ton. But at a point, for example, halfway freightwise between Pittsburgh and Chicago, the Pittsburgh mills are selling steel delivered at $43.80 per ton, and the Chicago mills, if they also sell at that halfway point, must meet the Pittsburgh-plus price, $43.80. The Chicago mills, therefore, must cut their Chicago price double the freight rate to that halfway point. They must sell at a delivered price, $43.80 instead of the $47.60 delivered at Chicago, and must pay the actual freight from Chicago to the point of delivery, another deduction of $3.80. The result is that while the Chicago mills receive for steel alone, excluding the freight, $47.60 when they deliver to Chicago consumers, they receive only $40.00 for the same steel, excluding freight, when they sell to consumers halfway to Pittsburgh. The same steel, made at the same mill and sold on the same day, is sold at $47.60 to Chicago consumers and at $40.00 to customers halfway to Pittsburgh.

This kind of discrimination exists at all delivery points where the Chicago price (which is the Pittsburgh price plus the freight from Pittsburgh to Chicago) plus the actual freight from Chicago, is greater than the Pittsburgh price plus the through freight from Pittsburgh to the same delivery point. And, owing to the peculiar layout of the freight schedules of the country, these points of cut prices for Chicago-made steel extend even west of Chicago. At Davenport, Iowa, for example, the freight from Pittsburgh is $9.50, and the freight from Chicago is $3.40, so that, when the Chicago mills are selling to Chicago purchasers at $47.60 (the Pittsburgh-plus price at Chicago) they are selling the same steel to Davenport at $49.50 and are then deducting the actual freight from Chicago to Davenport, leaving them only $46.10 for the steel alone when delivered to Davenport as against $47.60 when delivered in Chicago.[5] This comes about through the fact that the through rate from Pittsburgh to Davenport is less than the sum of the two local rates from Pittsburgh to Chicago and from Chicago to Davenport, and that Chicago must meet the Pittsburgh price delivered at Davenport. In a few cases, as for example, Madison, Wisconsin and a certain Rocky Mountain territory, it happens that the through rate from Pittsburgh is exactly equal to the sum of the two local rates from Pittsburgh to Chicago, and from Chicago to Madison or the Rocky Mountains. In such cases there is no discrimination at Chicago because the Chicago mills are charging the Madison consumer exactly the same price for steel alone at Chicago as they charge the Chicago consumer at Chicago. On the whole, however, these points for which the Chicago mills, after deducting freight, receive the same price as at Chicago are few in number, and it is probably true that the Chicago mills receive their highest price for steel on about one-third of their sales and that they cut their price on two-thirds of their sales.

In contrast with these illustrative facts, the economic analysis of a free and equal market consists of two main points. First, as to the commodity itself which is bought and sold. A true market for steel is a market where nothing but steel is bought and sold, just

as a market for wheat is one where only wheat is bought and sold. But if the different buyers of wheat, for example, are compelled, by a trade practice or otherwise, to buy variable amounts of oats or butter or any other commodity in order to get title to the wheat, then that practice violates the first essential of an equal market, namely, a standardized and uniform product. So, if the buyers of steel are compelled, by a trade practice, to buy, at the same time, variable amounts of another commodity, freight, then that is not a true market for steel—it is a market for steel plus variable quantities of freight. Although rolled-steel products, as already mentioned, have been highly standardized for the convenience of trade, yet the buyers of steel are not permitted to buy that uniform standardized steel. They must buy variable amounts of freight at the same time. A true market for steel is one where steel alone is sold and not bundled up and sold with variable amounts of something else.

Second, along with this definition of a standardized product is the accessibility of both buyers and sellers to that market. A truly free and equal market is one where all buyers and all sellers come together at the same time and place, and where all of them have adequate knowledge promptly of the prices that competing buyers and sellers are paying and receiving. If such a market is provided, then no buyer will be compelled to pay a higher price, at that time, than other competing buyers on that market, and no seller will be compelled to accept a lower price than other competing sellers on that market. This is the so-called principle of indifference in economic theory which simply means that, if a buyer is entirely free to change his purchases from one seller to another, he will promptly change from a high-price seller to the best low-price seller; and if a seller is entirely free to change his customers to whom he sells, he will promptly change from a low-price customer to the best high-price customer. This is always the case on a truly free and equal competitive market, and the result of it is that there are no discriminations in prices. Everybody pays or receives the same price at the same time for the same commodity. No buyer is held off in a corner by himself and charged a higher price than other buyers are charged, and no seller receives a lower price than other sellers are receiving at the same time and place.

This truly free and equal market does actually exist in many places, as, for example, on the stock exchange or the produce exchange, where all sellers and buyers are actually present in person or through their brokers. But it exists only to the extent that a code of rules and regulations has been adopted and is enforced, designed to prevent unfair practices and to exclude persons who violate the rules. When an unfair practice is discovered on the stock exchange or produce exchange, a new rule is adopted in order to stop it. This new rule is adopted on those exchanges by the joint action of both the buyers and the sellers, in order to be fair to each. The same is usually true of other markets, and hence, over a period of years, every free and equal market is built up by means of rules and regulations jointly adopted from time to time in order to prevent the discriminations, unfair competition or unfair practices which had previously crept in.

Not every market can be made as free and equal as the stock exchange or the produce exchange, but every market can be brought towards that ideal by exactly the same method of new rules and regulations designed to prevent as much of the unfair trade practices as may have been found to be injurious to business or oppressive to the public. If the situation is such that the buyers and sellers cannot get together and adopt these rules jointly, then the government must step in. And it was exactly for this reason and for

this purpose that the Federal Trade Commission was created with power to investigate and ascertain unfair practices and discriminations, injurious to the public, and then to order the parties to "cease and desist."

In this particular case of Pittsburgh-plus, it is seen that the buyers are prevented by the delivered-price system from competing with each other at the points where steel is produced, and hence many of them who buy from steel mills other than those located at Pittsburgh are paying higher prices than their competitors in other localities who buy from the same mills. There are no discriminations whatever in the price of steel that is actually made in Pittsburgh and shipped from Pittsburgh. Everybody, no matter where he uses the steel, pays a uniform price for a standardized product at the mill base in Pittsburgh and then pays the actual freight from Pittsburgh to the point of delivery. There is no unfair practice and no discrimination at Pittsburgh, and the Pittsburgh market for steel actually produced in the Pittsburgh district and sold at the Pittsburgh price at Pittsburgh, plus the actual freight from Pittsburgh, is as near the economic and legal idea of a free and equal market as is probably possible in any manufacturing industry.

Whether there is or is not a monopoly at Pittsburgh makes no difference, as far as this case is concerned. Even if it could be shown that there is a monopoly of the mills located at Pittsburgh, yet that monopoly certainly does not practise discrimination between its customers. It charges them all the same price at the same time. But this case of Pittsburgh-plus is not grounded on the allegation of a monopoly, but on the allegation of a discrimination. It is not a suit brought under the Sherman Anti-trust act, like the former dissolution suit in which a conspiracy was alleged, but a suit brought under those clauses of the Clayton act and the Federal Trade Commission act which prohibit unfair methods of competition and prohibit discriminations that tend towards monopoly or suppression of competition. And these alleged discriminations are not practised by the Pittsburgh mills. They are practised by the Chicago mills and the Duluth mills and by all mills away from Pittsburgh, both of the Steel Corporation and the independents, that follow the Pittsburgh-plus delivered-price system.

The question then is, why cannot the customers of the steel mills themselves break down this Pittsburgh-plus system of discrimination, as they broke down the former Pittsburgh zone-plus system? The answer is that the contracts for sale of steel are so drawn that the price of steel is always a delivered price, and the buyers of steel have no option of buying steel at the point where the steel mill delivers it to the railroad, but are always compelled to buy it at the point where the railroad delivers it to the customer.

There are two ways, conceivably, in which the consumer might break down the system; one is by collective action, the other is by competitive, individual action.

The Steel Corporation voluntarily abandoned the Pittsburgh-plus system for Birmingham in 1908 on account of the collective protest of the southern consumers of steel, and the Birmingham mills were then placed on a Birmingham base price instead of a Pittsburgh base price. Likewise, in 1922, after this suit had been started before the Federal Trade Commission by the collective action of the consumers, the steel companies placed the Chicago mills on a Chicago base price, for a large part of their products. But this voluntary collective pressure has two defects. The steel companies retain the delivered-price system, whether it be on a Birmingham base, or a Chicago base, or a Pittsburgh base, and there is no assurance that they may not return to the Pittsburgh base, as they previously had done on three or four occasions after temporarily abandoning it.

The other method of breaking it down would be to follow the individual competitive method by which the zone system was broken down. Suppose the Federal Trade Commission should order the delivered-price system to be abandoned, and the steel mills were thereby required actually to sell the steel at the mills and to give title to it or full legal control of it, at the mills, not including any freight, other than switching charges, in their prices. The steel companies would then pay only the switching charges and the buyers of steel in all the western consuming points would then own the steel, or have full legal control of it, as soon as it was delivered to the distributing railways. The steel companies in Chicago, if they then attempted to maintain the same Pittsburgh-plus practice with the same discriminatory prices for steel, would have to make a different price, at Chicago, for different customers, depending on the destination to which the customer wished to ship his steel. A Chicago customer or a Madison customer would be quoted, say, $47.60 for steel at Chicago. A customer halfway to Pittsburgh would be quoted $40.00 for steel at Chicago. It would be a simple trick, then, for a Chicago customer to purchase steel, saying that he wished to use it at some other point, say a point halfway to Pittsburgh, for which the Chicago mills sold at $40.00. Then the Chicago purchaser, having obtained absolute title to or legal control of, the steel at Chicago, and being bound by no contract to use it in any particular locality, could change his mind and keep the steel at Chicago. All of the Chicago purchasers, and in fact all purchasers, no matter where located, would be compelled by competition among themselves to adopt a similar trick, and the Chicago mills would immediately be compelled to adopt substantially a uniform mill base price at Chicago for all purchasers of steel.

It is a situation something like this that enabled the railway companies to prevent the Pittsburgh-plus practice from even being started in the case of steel rails and in the case of all steel required for repairing cars and engines. The price for steel rails has, for over 20 years, been a mill base price, at all steel mills, and not a delivered price, but it is exactly the same at Pittsburgh, Chicago or Birmingham. Why should the railway companies have been able to break down the Pittsburgh-plus practice when manufacturing companies were not able to break it down? The answer is, simply because the railway companies can take delivery of steel at any mill and pay their own freight. They are themselves in the freight business and can prevent the steel companies from going into that business. The Pennsylvania Company could not be compelled to pay $47.60 for rails at Chicago if they could buy the same rails at $40.00 at Pittsburgh, as the railway company can take delivery at Chicago or at Pittsburgh. It would therefore throw all of its purchases to the low-price mills at Pittsburgh, and the high-price mills at Chicago could make no sales.

But manufacturing companies, under a delivered-price system, cannot take delivery at any steel mill—they can take delivery only where their plants are located, since they do not have branch plants and do not own railways. Hence the manufacturing companies are cooped up, each in its own little locality of delivery, but the railway companies have an option of taking delivery at any mill from Maryland to Colorado. The market for steel rails is a free and equal market, in the sense that there are no discriminations, because all of the buyers and all of the sellers of steel rails are on the same market at the same time, regardless of locality. The market for other forms of steel is not free and equal, because the buyers cannot come together at the steel mills and there compete with each other, but are kept at a distance by the delivered-price system.

Hence the contention of the steel company, in its defense, that each locality of delivery is a separate market for steel, and that the steel *producers* compete with each other in those several markets is not a proper notion of a free and equal market. The steel companies may perhaps compete with each other, in the several localities of delivery, by the arts of salesmanship and the allurements of prompt delivery, or even by cutting prices, but the *consumers* of steel cannot compete with each other so that all of them will get the same price for steel alone, at the same time, unless they can go to the steel mills and buy at the mills. It is this inability of the steel consumers to compete with each other at the mills which is the secret of the discrimination that flows from the Pittsburgh-plus practice.

The rather simple remedy is merely to prohibit the delivered-price system; then the buyers of steel are smart enough to break down the discriminations in so far as they believe that those discriminations place them at a disadvantage in their competition with each other.

The other defense of the steel company, namely, that Pittsburgh is the point of surplus production, whereas Chicago and elsewhere are points of deficit production, such that the price of steel in the other places must be high enough to enable Pittsburgh mills to sell and pay the freight, turns also on the notion of a free and equal market. The tendency in such a market is for the price paid by all customers to come down to the level of the price paid by the most favored customers. If the price is kept high in the home market and is lowered only in the foreign or distant market, then this practice is that which is known as "dumping." And the practice of dumping indicates a surplus and not a deficit. The Pittsburgh mills do not practise dumping, under the Pittsburgh-plus practice, but the Chicago mills do practise it for all of their sales outside the localities of highest net return at the mills. The freight system furnishes a kind of protective tariff, and, like the protective tariff, enables the local producers to maintain high prices at home and dump their surplus at lower prices in other localities. Instead of Pittsburgh being the point of surplus production and Chicago the point of deficit production, the dumping practice of the Chicago mills indicates *ipso facto* a surplus at the Chicago mills which is dumped at lower prices in other localities.

And this is what the community of ultimate consumers expects and is entitled to have from a free and equal competitive system of making prices without discriminations and without dumping. If competition is free and equal, then each increase of supply, made possible by low costs of production, will bring the prices paid by all purchasers down nearer and nearer towards that low cost of production. If the Chicago costs of production, as stated by Judge Gary in 1918, are 20 percent less than the Pittsburgh costs, and if, instead of keeping up the Chicago price and dumping the resulting Chicago surplus at lower prices elsewhere, they reduced the high prices at Chicago or Madison to the level of the lower prices when delivered at other points, then we should have the natural result of a free and equal market. It is the discriminations of the Pittsburgh-plus practice, and its dumping of a surplus, both of them concealed by the delivered-price system, that prevents the western immediate consumers of steel from competing with each other and thus prevents the western ultimate consumers from getting the advantages of the low costs of production of the western steel mills. A free and equal market is an immediate advantage to the immediate consumers and an ultimate advantage to the ultimate consumers.

This Pittsburgh-plus practice reveals quite clearly what it is that constitutes a modern market, in contrast with those primitive markets which furnished the basis of facts for the classical and Austrian economists. Henry Dunning McLeod was the first economist to maintain that, on a market, it is not physical commodities but legal rights that are bought and sold. He described thereby the great modern markets in contrast to the early commodity markets. In a primitive market the producers or merchants actually bring their commodities to the market, and there occurs then a double transfer—a physical transfer of a commodity and a legal transfer of ownership of that commodity. This kind of market survives in municipal market places and in retail business. On such markets, when the seller hands over the physical goods to the buyer, the legal control of the goods is automatically transferred by operation of law.

But in a modern wholesale market the physical goods are not actually brought to the market place, but only the title, or, at least, only the legal control of the goods, is transferred from seller to buyer. The physical designation of the goods is made accurate by the three stipulations of a standardized product, a specified place of delivery and a specified time of delivery. Then the physical control of the goods goes along in the hands of the agents, laborers, railway employees and so on, who actually handle the goods, but these agencies are operating under stipulations agreed upon by those whose behavior in law is deemed to determine the legal control of the goods.

Since it is the law, therefore, that determines the legal control of goods, the law has at all times taken into account, more or less, any injustice, discriminations, or oppressions which occur when this legal control is transferred under the authorization of the law. And this determination by law might be extended to cover the *place of delivery* of title or legal control, just as much as it has already been extended to cover many other practices involved in the legal, as opposed to the physical, transfer of commodities. It is upon this presumption that the plaintiffs in this case ask for an order from the Federal Trade Commission, designating the place where legal control of steel is transferred from steel producers to steel consumers.

AUTHOR’S NOTE

The papers of July 23, 1924, announce the findings and opinion of the Federal Trade Commission, ordering the discontinuance of the Pittsburgh-plus system by a vote of four to one of the commission. The dissenting commissioner is reported as saying: “If the economists are right, the requirements of the situation should be met only by legislative recognition of the necessity for more exact statement of the scientific relation between business and economics and a declaration of that relation in the form of a law of general application.”

NOTES

1 U. S. *v.* U. S. Steel Corp., 40 Sup. Ct. Rep. (1920).

2 The freight rates are those of 1920.

3 Subsequent figures furnished by Judge Gary did not show the differences to be as extreme as these.

4 Frank A.Fetter, of Princeton University; W.Z.Ripley, of Harvard University; and John R.Commons, of Wisconsin University. Cf. *Quarterly Journal of Economics* (May, 1924), "*The Economic Law of Market Areas,* by F.A.Fetter."

5 Figures are for the year 1920.

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LAW AND ECONOMICS

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Of the five elementary concepts or principles of economic theory, at least four are functional also to the science of law, namely, Scarcity, Futurity, Custom and Sovereignty. A fifth concept of economics, Efficiency, connects that science with the physical sciences.

Scarcity, for the economist, shows itself in the so-called "law of supply and demand," or rather in the functional relations of the three variables, Supply, Demand and Price, since a change originating in the dimensions of any one of these variables of scarcity is followed by changes in the dimensions of the other two. But Scarcity, also, for the jurist is fundamental to his concept of property, since the only significance of any sometimes alleged right of property attaching to objects whose quantity is unlimited in supply and can therefore be used by all persons, like air or sunlight, is in their appurtenance to objects whose quantity is limited in supply and can, therefore, be excluded from use by other persons, like radio stations and land space. Neither proprietors nor courts can get jurisdiction over objects unlimited in supply.

Having the same foundation in the Principle of Scarcity, the question arises, why have not the two sciences of law and economics been treated as one and been advanced together? In our Anglo-American universities they have been separated, but on the continent of Europe we know that they are more closely united. One reason is the priority of England in inventions and manufactures, which attracted the pioneer English economists towards the physical sciences of production of wealth, and they based their theories mainly on that division of economics which has to do with man's control over the forces of nature, namely, Efficiency, under the name of Productivity.

Another reason is the influence of Jeremy Bentham in his criticism of Blackstone. Bentham asserted that Blackstone's reliance upon custom and the common law was a reliance on mere "ancestor wisdom" supported by "authority," and he set up, in its stead, the pains and pleasures of individuals supported by "reason" as the foundation of legal, ethical and economic science.[1] This view fitted in precisely with the extreme individualism of English economists and made it possible for them to assume that the largest production of wealth through the selfishness of individuals was equivalent to the ethical principle of the maximum happiness of all. Great productivity was great happiness. Ricardo, the founder of English economic theory, 100 years ago, accepted Bentham's rendering, and hence custom was apparently eliminated from English economics, so that it came to be based on "happiness" and "reason" instead of "custom" and "authority."

But economists did take for granted the largest contribution which custom had made to economics, namely, the custom of private property, so that English economic theory was worked out on the three principles of productivity, selfishness and property. It was this "classical" theory of economics, thus propounded by Bentham and Ricardo, that split afterwards into the socialism of Marx and the anarchism of Proudhon.

In more recent times, that is, within the past forty years, economists have begun to incorporate into their theories contributions from three sources, Sociology, Trade Unionism and Public Regulation, which run counter to, or at least transcend, much of the inferences drawn from either Bentham's individualistic pains and pleasures or the supposed identity of efficiency and happiness, and which turn out to be the part played by Blackstone's custom upon economic life.

However, this economic concept of custom is a considerable enlargement upon what I understand Blackstone and the lawyers to mean by custom. They identify custom with the common law, whereas, from the economist's approach, the common law is a special case of Darwin's "artificial selection," by the courts in this instance, of what are deemed to be good customs, and the rejection and penalization by the courts of what are deemed to be bad customs. Thus the practices of trade unions may be deemed to be bad customs, but the similar practices of business men may be said to be good customs. The economist, or sociologist, takes all customs into account, and the word Custom, in his usage, may be said to have the three meanings of Habit, Common Practices and Common Law. Habit is the practices of individuals which may or may not conform to the common practices of those with whom he is associated. Common practices are the pressure of opinion and the exclusion from intercourse by the associates of the individual which thereby require him to conform if he would live and prosper. And the common law is the protection by the courts, by means of the physical penalties and immunities of government, of approved practices and the exclusion of disapproved practices.

From this point of view it can be seen, I believe, how close is the relation between Economics and Law. Economics becomes the Common Practices of feudal lords, of the early guilds, of agricultural communities, of merchants, manufacturers, business men, of workingmen, professional men and others, in their daily transactions with each other by way of creating and obtaining an income from the earth and from each other. And the common law evolves in proportion as the courts decide disputes in accordance with the common practices of these several classes deemed to be good and proper.

Perhaps this notion does a little violence to a certain notion that the common law is the primitive custom of England, as suggested in the distinction between the common law and the law merchant. But the law merchant was simply one section of the approved common practices of business men, first enforced in their own courts and then enforced, with enlargements or restraints, in the common law courts. These latter courts have been taking over these business practices during something more than 300 years, and out of them they have developed by "artificial selection" the modern concepts of incorporeal and intangible property, additional to the primitive concepts of corporeal property pertaining to the early common law. Incorporeal property is the legal enforcement of approved contracts; and "intangible" property has come to be distinguished, especially in the public utility and labor cases, as the "exchange-value," or "purchasing power," of any and all property upon the markets, such as the exchange-value of the intangible good-will of a business as well as the exchange-value of the physical plant and inventory, or the

exchange-value of labor on the labor markets, or the purchasing power of credit on the money markets, and these purchasing powers constitute the business man's "assets" and the laborer's wages which are their intangible property. The two concepts of incorporeal and intangible property are merely two kinds of business customs, the one referring to creditor and debtor transactions, the other to seller and buyer transactions, as distinguished from the older customs of feudalism and the early common law which referred mainly to lands, physical chattels and personal services, before the great development of modern wholesale markets.

It was often with difficulty that the common-law courts could be induced to take over the practices of business men, an illustrious example being the rejection by Lord Chief Justice Holt, in 1702, of the negotiability-that is, the "intangibility" in the recent sense of the word-of the goldsmiths' notes, the foundation of modern banking, on the ground, in part, that these particular business men in London were presumptuously trying "to make a law to bind all that did deal with them."[2] A similar difficulty is observable during the past hundred years, after the courts had fully accepted the good practices of business men as normal, when it attempted to have them recognize also the practices of associations of workingmen. Workingmen have set up their own courts endeavoring to enforce their own customs, and, in many cases, they have set up jointly with their employers so-called arbitration boards, which are industrial courts. Here it is found.that nearly always the disputes turn, directly or indirectly, on the fitness of certain shop rules designed to protect the workers in their jobs, and thus, in effect, to create a kind of property right in the job. Anyone who goes through the hundreds of labor cases reported from the courts of Australia will find that those courts have actually taken over the shop rules of the workers, and these common practices have become the common law of Australia. Here we find the creation by the courts of a new kind of intangible property, the job, and the process of its creation, by artificial selection, is almost an identical repetition of the process in English and American history of creating the incorporeal and intangible properties of business men, by way of taking over and enforcing their good practices, customs, or rules, formerly enforced in their own way in their own private courts of the guilds, the law merchant and in the *pie poudre* courts of the markets and fairs.

Thus the science of economics, which is a science of the good and bad habits and common practices of farmers, landlords, business men, workingmen and others in their mutual adjustments to scarcity of resources and in their competitions and conflicts imposed upon them by that scarcity, is a science of the fundamental concepts on which the science of law is also grounded.

But there is a reverse action wherein the science of economics is being grounded, in recent times, on concepts derived from the common law, quite contrary to Jeremy Bentham. This turns on the question, What is the ultimate unit which furnishes to economics its starting point? Economists have sometimes been apologetic, sometimes defiant, sometimes cynical, towards the criticism that they have based the whole of their economic theory on the selfishness of the individual regardless of the interests of others. In order to offset this animadversion some of them have at times made a fresh start in the field of ethics or law, as a kind of addendum, and there has resulted an irreconcilable dualism of the two principles of the individual and the society. But the courts, being directly in contact with the practices of business and compelled to decide disputes arising out of those practices, have built up both a method of approach and a joint concept of the

individual and society which completely transcend this dualism and give us a starting point that is both individual and social.

The method of approach referred to, is that of a conflict between two persons, the plaintiff and defendant, who stand, through the doctrines of precedent and equal protection of the law, as representatives of two opposing classes of people. The court always begins with two conflicting persons, instead of one selfish person, and with the common practices of two opposing classes of persons instead of a mass of disconnected individuals, as the economists had done in imitation of Jeremy Bentham. This conflict of interests, then, is transcended by applying a rule or custom that has been found to be good, in that it lies in the direction of what is believed at the time to be the common interest of individuals and classes within the same group or society. The court begins with a transaction, where economists, following Bentham, begin with individuals. Thus the method of approach is both individualistic and socialistic, and would seem to afford a point of conciliation between the great antagonistic schools of economic thought, the "classical" economists led by Ricardo, the socialists led by Marx, and the anarchists led by Proudhon.

Growing out of this point of approach and in order to do justice to the parties in view of the relations and obligations previously assumed, the courts have built up the joint concept of individual and society, above referred to, namely a "going concern" which acts as a unit, though composed of individuals, and is endowed with many of the legal attributes attached to individuals. They have thus converted the economists' "individual" into a set of relations, habits, transactions, or customs, of associated individuals. When we look at the matter objectively and without the subjective bias of our individualistic pleasures and habits, we must perceive that the true unit of economic theory is not an individual but a going concern composed of individuals in their many transactions of principal and agent, superior and inferior, employer and employee, seller and customer, creditor and debtor, bailor and bailee, patron and client, etc. Each individual in society, for the purposes of economic theory, comes to the surface as a member, a participant, a "citizen," in several of these going concerns, shifting from one to another and performing the work of certain jobs, or positions, or other set of transactions, in each particular concern for the time being, the supreme concern being the political one which attempts to monopolize the physical coercive power of society.

Here, it seems to me, the analysis made by Professor Hohfeld,[3] of legal rights, duties, liberties and exposures, is of universal application to all going concerns. His is practically an analysis of the way in which the common practices of any going concern control the individual members of that concern and hold them to the conduct necessary to preserve the existence of the concern. For, as stated by Professor Corbin,[4] these rules affirm what the individual member may expect that he "can, cannot, may, must or must not do," in so far as the superior interests of the concern are deemed to be at stake. These principles are just as applicable to the shop rules of an industrial concern, or to the ethical rules of a family or any of the many cultural concerns, as they are to the supreme political concern. The differences reside mainly in the sanctions brought to bear upon the individual and in the technical meanings and more elaborate manipulation of the words as used by the lawyers. In the political concerns the sanctions are physical coercion or physical immunity, and in the others the sanctions are wages, rents, interest, profits, jobs and other economic or cultural gains or losses. Where, as in Australia, the shop rules of industrial

concerns are taken over by the courts, then the legal sanction of threatened violence is added to the economic sanction of threatened poverty, with such differences in interpretation as may be deemed fitting by the courts.

It will be seen that this concept of a going concern, with its common practices and common law, changes very greatly the several concepts of the individual, of the state, and of property entertained by Benthamistic economists. Instead of a passive "globule of desire" following the parallelogram of physical forces which bear down upon him, as Veblen[5] would say, it substitutes an active person associated with others and participating in and controlled by the practices common to all. And it makes of the state itself a much less dominant coercive and arbitrary power than that conceived by the classical economists, the socialists and the anarchists. For it interjects between the state and the individual a complex of habits, practices, opinions, promises and customs which are both a substitute for state action and a highly intractable force which even the most powerful state cannot override, or will not if its officials care to hold their jobs.

This gives a very different idea about property. It corrects the anarchistic doctrine of the early economists that private property is an original, natural and inalienable right that cannot be taken away by the state, as well as the socialistic, and even occasional lawyer's doctrine, that property is the mere creature of sovereignty and can be changed in whatever way the sovereign may command. In place of these mechanical and coercive doctrines is substituted the concept of property as a complex set of acquired rights, of imposed duties, and of permitted liberties and exposures, derived from a great variety of customs which landlords, guilds, business men and laboring men have been influential enough to get the courts to authorize; and further, that these fundamental social relations of rights, duties, liberties and exposures are grounded, not on the state, but in the daily habits, practices and customs of the people. I take it this is the grand contribution which the science of law gives to the science of economics. It introduces Custom into economic theory where, without it, there is no bridge between the anarchistic sovereignty of the pleasures of the individual and the socialistic sovereignty of the commands of Legislatures and Soviets.

The modern importance of this concept is very great, for it underlies all the legislation of the past thirty or more years, regulating the employment of labor, regulating public utilities, regulating competitive business and regulating the banking business. If the individual is supreme there can be no regulation—if the state is supreme, there can be no freedom. But if, between the two, is the regulative power of custom, then the choice lies only between good customs and bad customs, both of them already to be found in the world about us, and it is this that gives to economic science that ethical theory which its leaders have always sought or assumed, the theory of Reasonable Value. For reasonable value is none other than that valuation which arises from good practices of business and industry, distinguished from the anarchistic or socialistic, or dictatorial, or arbitrary, or destructive, practices, not conforming to the concensus of those who are deemed to be reasonable men, in that they conform to the custom of the time and place. Here the word "reasonable," means, not Bentham's meaning of intellect, but Blackstone's meaning of custom.

The other concept referred to above—Futurity—is common to the sciences of economics and law, as distinguished from the physical sciences. When economists based their theories on analogies to physical sciences, from which the Principle of Efficiency is

derived, they pictured human conduct as a resultant of physical forces which pushed mankind forward from the past into the present. The individual was subject to "natural" laws which he could not overrule. The so-called "law of supply and demand," derived from the Principle of Scarcity, was a physical force of this kind. And correspondingly, the concept of Time, in the physical sciences, is that of a flow of events proceeding inevitably from antecedent to consequent. But when we look at the human will, or rather human Willingness, as the force with which economic science has to do, in contrast to the physical forces of gravitation, electricity, mechanics, and so on, then we find that it is the hopes and fears, the expectations and cautions, the foresight and impatience, respecting the future that determine what shall be done in the present. We have, both in economics and in law, many terms indicating this futuristic aspect of Time, such as motive, intent, purpose, wants, desires, security, investment, property, assets, liabilities, interest, capital—in fact, the concept of Value itself, on which economic theory, as well as legal theory, turns, is a synthesis of all these other concepts of futurity, and, as such, is always a concept of the present importance of things and persons and classes of persons in view of their expected uses and behavior in the immediate or remote future.

It is, indeed, this Principle of Futurity that changes the early economists' concept of human nature from that of a passive resultant of forces to that of an active originator, or rather chooser, of forces. Needless to say, the science of law, which studies the rules laid down for the guidance of conduct, is also a science wherein that ultimate mystery, Time, reveals itself as Future Time. But it has been only within the past forty years, through the insight of the late Minister of Finance of Austria, Böhm-Bawerk,[6] that Future Time has been given a truly functional position in economic theory as one of the variables which determine the dimensions of the other variables, Efficiency and Scarcity. This was a noble contribution to economic theory and evidently furnishes another link uniting law and economics, though Böhm-Bawerk himself did not carry it forward to that conclusion. This was doubtless because his concept of objects of property was that of "corporeal" property, equivalent to the physical or materialistic "capital" of economic theory in its earlier stages.[7] But when economic theory passes over to the "incorporeal" property (the creditor and debtor relation) and to the "intangible" property (the seller and buyer relation) of the law, then Böhm-Bawerk's Futurity is none other than the very attribute of Time whose expected outgo and income determine, both in law and in economics, the present value of going concerns and workers' jobs.

The interdependence of these five variable dimensions of human willingness, namely, Efficiency, Scarcity, Futurity, Custom and Sovereignty, may be seen concretely in the concept of "capital," which is both an economic and a legal concept. Different economists and different schools of economists have differed widely as to which of the first four variables they should select to represent "capital," though the concept is really that of the interaction of all five. At one time capital was the quantity of labor devoted to production. At another it was the accumulation, from the past, of physical products devoted to future production. At another it was the money which purchases commodities and labor. At another it is the capitalization in the present of expected net earning power in the future. If we put these various ideas together, all of the implied in the concept of Capital, we find that "capital," which is a modern concept, is the incorporeal and intangible properties of the law that have been recognized conformably to the customs of business. Incorporeal property (the creditor and debtor transaction) is created and

becomes intangible property (the seller and buyer transaction) on the so-called money market, and a rate of interest or discount at the banks is the price paid by the debtor for that scarce service of a quantity of purchasing power loaned or hired during a lapse of time between the present when physical goods and labor services are purchased, and the future when their products will be sold and the purchasing power returned to the lender. It is the exchange-value of this incorporeal property, Credit, that constitutes this purchasing power, and it is this purchasing power which is intangible property or assets, yielding to the business man a legal control over commodities and the products of labor, through contracts and alienations, during the physical process of production and transportation.

Hence the prices paid, by means of this purchasing power, are paid, not for commodities and services, but for legal control over commodities and services. The distinction may be seen by comparing primitive markets with modern capitalistic markets. In the primitive markets of the fairs and *pie poudre* courts both the physical control and the legal control went together. A seller handed over a physical product to the buyer and the law read into the act a transfer of legal control. But with modern wholesale business, under the direction of modern business concerns, after the desuetude of common law and legislative rules against forestalling, regrating and engrossing, the transfer of legal control is widely separated from the transfer of physical control. The legal control moves on from business man to business man in accordance with the customs of the credit system, while the physical control moves on from employee to employee under the commands of business men. The business practices determine the place and date of transfer of legal control, and the prices agreed upon in the markets always are fixed as the price paid for legal control specified or implied by the two dimensions of space and time. "Futures" have a price as well as "spots," and a "delivered" price is different from a "mill-base" price.[8] Each is the exchange value of incorporeal and intangible habits, customs, practices and promises of business men, approved by the courts and guided by the legislatures and constitutions, and directed towards the control of commodities and services. Thus the concept of Capital, so fundamental in modern economic theory, is that of the interaction of the five variables that measure and determine the activity of all economic concerns, namely, the Efficiency of labor and management, the relative Scarcity of things and services at specified times and places, the Futurity of a flow and a lapse of time, the legalized Customs of business men and the sovereignty of the State. A change originating in any one of these five dimensions of human Willingness is followed by changes in the dimensions of the others.

Other illustrations might be given of the fundamental unity of law and economics, for example, Value. This puzzling term has passed through many vicissitudes in economic theory and has recently become the outstanding term in psychology and ethics, as distinguished from the former preeminence of pleasures pains and Bentham's so-called "reason." The law contributes still another variation, the concept of "reasonable value." Practically and objectively, the various meanings, as employed in law and economics, may be contrasted as Efficiency values, Scarcity values and Ethical values. All three of these meanings imply Futurity. Efficiency has to do with the increase in quantity of output in the form of products or services, compared with the quantity of input in the form of man-power. But the significance of efficiency does not lie in the mere physical products but in their physical qualities and powers which are useful. While an increase of efficiency is increasing the quantity of commodities it is increasing, in exactly the same

amount, the quantity of useful physical qualities or powers, sometimes known as "use-values" or "uses," or merely "usefulness," belonging to commodities, such as the nutritive qualities of wheat, the tractive powers of automobiles, and so on. These useful qualities and powers are the Efficiency Values of industry.

But scarcity values operate in exactly the opposite direction. An *increase* in the quantity of wheat, or the quantity of automobiles (other things remaining equal), *diminishes* their scarcity values, that is, their prices, although *increasing* the total amount of their efficiency values. And a *decrease* in the quantity of wheat or automobiles *increases* their scarcity values or prices by *diminishing* the quantity of efficiency values, or useful qualities. Now it is the engineer, the technologist, the labor manager, the laborer, who increases the efficiency values by *enlarging* output, but it is the business man, or rather the business function of all men, which maintains or increases the scarcity values by *withholding* output. The technologist is a specialist in efficiency, the business man a specialist in scarcity. The technological function of the will adapts itself to, and thus enlarges its control of, the forces of nature, but the business function of the will adapts itself to, and thus enlarges its control of, the forces of demand, supply and price.

This difference is really the difference between corporeal and "intangible" property, under the modern meaning of the latter term as distinguished from "incorporeal" property. Corporeal property refers to the physical forces of nature; intangible property is the business man's assets, or purchasing power, on the markets, that is, the exchange values, or rather scarcity values, of his corporeal, incorporeal, and even intangible property, depending upon their relative scarcities on the commodity markets, the labor markets and the money markets.

When next a dispute arises as to the prices, that is, the scarcity values, of commodities or services, in the hundreds of cases continually coming before the courts, the question may arise as to what is the "reasonable value," that is, the *ethical scarcity* value, under the circumstances, of that commodity, or service, or contribution to the common fund obtained as taxes, and so on. Herein the court, or the market commission, or the public utility commission, or the tax commission, or the arbitration board in labor cases, must take into account all of the five variable functions of Willingness already mentioned. It must consider the inducements to Efficiency, the circumstances of Scarcity at the time and place, the expectations of the Future, the good and bad practices of the two parties, as well as the good and bad Common Practices of similar persons under similar conditions and the legislative acts of sovereignty. These considerations are none other than the five interdependent functions of the human will which make up the science of economics, and the Reasonable Value of the law is therefore the summing up of the whole science of economics.

I have spoken of law and economics as two "sciences." If they are strictly sciences, as distinguished from the theories or hypotheses with which all sciences start, then they must have units of measurement by means of which to test their theories by experiment and to enable the different investigators and practitioners to speak the same quantitative language. Words give us theories, but numbers give us sciences. The science of economics, unlike the physical sciences, has two systems of measurements, a quantity measurement and a scarcity measurement, while the law adds the measurement of "reasonableness." The quantity measurements are derived from the physical sciences and apply to such dimensions as length, volume, weight, work, time and efficiency. But the

scarcity dimensions are derived from the markets, and apply to the dimensions of supply, demand and price. In America the lawful scarcity unit is the dollar, and the prices of all things on the markets are determined by their relative scarcities compared with each other and with the relative scarcity of the dollars themselves. The quantity measurement and the scarcity measurement always go together. Cloth is fifty cents per yard, wheat is $1.00 per bushel, and, in the "greenback" period, even the physical dollar unit of 23.22 grains of gold was as high as $2.00 measured in terms of the legal tender scarcity unit. It was the decisions of the highest court in the Legal Tender cases that changed the scarcity unit from corporeal property measured by weight and fineness to that incorporeal and intangible property, the promises of government which have a certain amount of purchasing power upon the markets. A tender of this paper money is considered to be a liquidation of indebtedness in all disputes that might come before the courts, and hence almost every business man and working man, in all sales, purchases and promises upon the markets, employs this incorporeal and intangible unit of measurement rather than the gold or silver unit.

Herein we have a special and extreme case of what seems to be the general principle underlying the concept of "reasonable value." Considering all the circumstances of all the people of the nation, the highest court decided, in effect, that it was reasonable for lower courts to employ, in deciding disputes, a unit of measurement which the people, through their representatives, had agreed upon. The principle is not so very different from that underlying the establishment of all units of measurement, whether of weight, length, coins, or other dimensions. They began as local customs, then were standardized into a common law for all the courts by royal decree or legislative act. In all cases the standards of measurements proceed from a concensus of opinion. The opinion may be mistaken in the light of history or logic, but, in the light of that which works reasonably well, under all the circumstances and in the opinion of those selected to decide because they are deemed to be reasonable men according to the custom of the time and place, such as a jury, a court, a public utility commission, an arbitration board, a legislature or similar body, Reasonable Value, when measured, is that degree of economic power through control of relative scarcities, which individuals may be permitted to exercise conformably to the habits, common practices, common law and common policies of the time and place.

If, in addition to the common law, we include statute law, as is needful for a complete idea of the unity of law and economics, then statute law, including constitutional law, the alleged seat of sovereignty, is rather a kind of organizing and experimenting with the efficiencies, scarcities, customs and expectations of the people, sometimes expediting them, sometimes inhibiting them. And the unity of law and economics, emerging, as it does, out of the same mysterious force, the Human Will, on which each science is grounded, becomes the interaction of Efficiency which creates a national output of human services, Scarcity which distributes the services as prices and income, Futurity which makes them valuable, Custom which regulates them, and Legislation which organizes and experiments upon them.

NOTES

1 “Fragment on Government,” 1 *Bentham’s Works* (1843) 221; “Book of Fallacies,” 2 *ibid.* 375.

2 Buller *v.* Crips (1702, K. B.) 6 Mod. 29, 87 Eng. Rep. 793

3 Hohfeld, *Fundamental Legal Conceptions* (1923); Commons, *Legal Foundations of Capitalism* (1924) 91.

4 Corbin, “Legal Analysis and Terminology” (1919) 29 *Yale Law Journal* 163.

5 Veblen, *The Place of Science in Modern Civilization* (1919) 73.

6 Böhm-Bawerk, *Positive Theory of Capital* (1891) *passim.*

7 Compare his *Rechte und Verhältnisse* (1881) *passim.*

8 Commons, “The Delivered Price Practice in the Steel Market” (1924) 14 *Am. Econ. Rev.* 505.

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THE PASSING OF SAMUEL GOMPERS

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Samuel Gompers was, in my opinion, one of the ten or twelve greatest Americans. It must be remembered that no great man had at any time during his life the unanimous consensus of opinion that he was truly great. His greatness was as much in his enemies as in his friends.

I judge this quality, not by eminence alone, but by persistence, intellect and fitness to the great circumstances of time and place. Each great episode in American history comes as a conflict and develops opposing leaders. Even death does not silence hostility. Neither Jefferson, Lincoln, Lee nor Wilson were unanimously considered great during their lives or after, but when we consider their indomitable will displayed through all the ups and downs of fortune, and the millions of people united under their leadership, we find therein the constructive signs of greatness. Only in the fields of philosophy, science and invention, where hostility and hatred usually have no entrance, do we find a species of general agreement, which is rather indifference, to the greatness of Emerson, William James or Edison. Since the time of our Civil War the qualities of persistence and intellect have been called out, not so much by political or sectional issues as by economic issues. This applies particularly to the concerted massing of the forces of capitalism and the forces of labor, in which two figures—those of John D.Rockefeller and Samuel Gompers—will always stand out, each in his own field, as the most representative and significant leaders of their time.

It is now twenty-seven years ago that I became personally acquainted with Gompers, and I have counted myself since then among his followers. I have watched him at each critical turn of his career, at each crisis in labor and in the fortunes of the American people; I have gone back in history through the early labor documents and newspapers, and through interviews with his associates and opponents of the earlier days, and I have even consulted with those who had detectives on his track, and I have found that at every point he was true and great.

Sometimes I have thought him to be ineffective, when I was endeavoring to get him to do something which I and others thought quite important at some labor crisis, and he merely promised that he would write an editorial about it the following month in *The Federationist*. But, when, since then, I have compared those impetuosities of mine with the nation-wide complexities which he had in mind I have realized what it is to have that

patience plus determination which makes a man truly a leader when the right time for striking the right blow actually comes.

His mind seemed to be rather slow in action, rather ponderous and heavy; his words came out as if measured off by schedule; he never could be accused of fury or boisterousness; yet there was an intensity and grimness about his thinking and speaking, a kind of solidity quite in keeping with his huge leonine head and deep furrowed features, with his square, thickset body and his short stature. He could launch a rhetorical blow at an antagonist with a massive and most effective brilliancy, as when he exclaimed to the Socialists, in a convention of the federation, that he had thoroughly studied them and their works and found them to be "economically unsound, socially wrong and industrially impossible."

THE RISE OF GOMPERS

By way of brief biography I may say that Samuel Gompers was born in London in 1850, of a Jewish family that had found its way through Portugal and Holland to England. He came to the United States in 1863 and located in New York. It was in 1867 that Karl Marx's *Das Kapital* came to New York, and forthwith the German immigrants, including Gompers's co-founder of the cigarmakers' union, Adolph Strasser, set to work studying and discussing that abstruse and monumental work. Gompers made no idle boast when he declared that he had made a thorough study of socialism. I have found that many of the real thinkers of the American labor movement have developed from a fundamental study of the Socialistic theories of Marx. But they also tried to test the theory by experiment. Before Gompers emerged in 1877 as the principal founder of American trade unionism he had been for several years in New York City in the centre of the Marxian theories and of effort to demonstrate their practicability by experiments on a small scale. I have not known any person more thoroughly grounded in the theories of Marx than Samuel Gompers. Indeed, at the 1881 convention, which organized the predecessor of the American Federation of Labor, Gompers was alleged by the followers of his chief opponent for the Presidency of the organization to be a Socialist and the candidate of the Socialists. In reality he was the candidate of that element that had mastered the theories of socialism and rejected them on the test of experiment.

There is, however, an explanation of the fact that his opponents in that convention could plausibly name him a Socialist. His opponent was John Jarret, the President of the Iron and Steel Workers' Union, an organization of skilled workers which joined faithfully with the steel owners in supporting the protective tariff. This union was at that time politically in alliance with the manufacturers and was therefore strictly committed to the capitalistic theory of the harmony of capital and labor. But though Gompers and his followers had rejected socialism as an ultimate goal, they had nevertheless accepted as much of the socialistic viewpoint as would divorce the unions from any political alliance with capitalists. In short, Gompers had learned from his study and rejection of socialism that labor organizations must cut loose from all political alliances whatsoever, whether socialistic or capitalistic, and must organize solely to get more wages, shorter hours and

better conditions, here and now, and by the laborers' own power of collective action. To a capitalistic unionist like Jarret, Gompers was a Socialist, but he was a *bête noire* to the true-red Socialist.

The fight between Gompers and Jarret was avoided, for Gompers yielded the Presidency to Jarret and was himself made Vice President. Two years later the steel workers withdrew because the federation passed resolutions condemning the tariff. Meanwhile Gompers was made President, and for forty-two years, from 1882 to 1924, with one exception, he had been the official head of the American labor movement, in so far as that movement made itself independent of capitalists, Socialists and politicians.

AS WORKER AND ORGANIZER

One cannot understand Gompers, nor, for that matter, the American labor movement itself, unless he is familiar with the life of Gompers, first, as a boy and young man in a cigar shop of New York at the age of thirteen, in 1863, to the age of twenty-seven, in 1877; and again, in the cigar shop from 1877 to 1886, when he became President of the reorganized American Federation of Labor. During this period he was an actual worker, for the total income of the federation was not enough to have paid him any salary before 1887.

I have said that he was a slow thinker. What I mean is that he thought in terms of experiment. "How does the theory work?" he asked himself. "How can I understand what a theory really is unless I see whether it fits the facts when actually put to work? Is a theory true that does not fit the facts?" But it takes time to think in terms of experiment, and a good deal of waiting has to be endured before the experiment proves, or disproves, or modifies the theory. When the experiment is finished, however, then the experimenter knows exactly what every sign and every motion actually means, and he can thereafter, for more than forty years in Gompers's case, know exactly, and before any one else knows, what action is immediately required. That was what Gompers learned as a boy and young man, in the ten or twelve years prior to 1877, when he carried on his experiments with socialism, and from 1877 to 1886, when he experimented with the Knights of Labor.

Local cigarmakers' unions had existed in New York City as early as 1864. The long period of depression of business, after 1873, led to the collapse of these and other unions, but the cigarmakers made a desperate recovery in 1877 and carried on a prolonged strike against the tenement-house sweating system. The strike was a disastrous failure. The unions had no funds, no discipline, no inducement to hold together as militant organizations during periods between strikes or periods of business depression. In such times they became mere debating societies, dwindling down until only the theoretical debater on cooperation, socialism, anarchism and labor politics held the floor.

Gompers and Strasser took the lead in reorganizing the cigarmakers. Strasser was given the ambitious title of International President, by which was meant traveling organizer for North America, and Gompers remained President of Local 144, continuing to work in the shop but also organizing unions out of hours. They accomplished four

things: they made the international officers supreme over the local unions; they increased the membership dues to unheard-of amounts in order to build up a fund; they concentrated the control of that fund in the national officers, and they adopted, or prepared to adopt, sickness, accident and unemployment benefits. This was the beginning of militant, persistent unionism in America. The cigarmakers' union became the model for all others. And when, twenty years afterward, in the last decade of the 1890s, another depression like that of 1873–1879 took place, Gompers could report to the Federation of Labor that, for the first time in history, the unions had weathered the storm.

In 1881, after other unions had copied the cigarmakers' union of 1877, came the next step, the "Federation of Organized Trades and Labor Unions of the United States and Canada." Gompers was Chairman of the Committee on the Constitution, and it was in his committee that the final plan of organization was worked out. This federation was reorganized in 1886 as the American Federation of Labor. The principles of organization adopted, entirely different from those of any other labor movement in this or any other country, were as follows: (1) There were to be no dual unions; only one union could be accepted for each trade in all North America; (2) no local unions were to be admitted; such unions must enter the International Union and get what representation they could through their national unions; (3) the delegates from each international union were to cast as many votes as were proportionate to the number of its members; (4) local or city trades assemblies and federations (composed of local unions of the several trades) were to have each only one vote; (5) each national union was to be completely self-governing over its own locals and free from domination by the federation.

NOT "GOMPERS MACHINE"

These constitutional principles of Gompers accomplished the purpose of their conceiver. The American Federation of Labor became, not a popular convention of delegates from the local unions, but a council of ambassadors and executive heads of national unions. Herein it was exactly the opposite of the Knights of Labor. What is a council of executives as distinguished from a popular representative assembly? It is a council of fighting organizations, each supreme in its own jurisdiction. It is a council of responsible executives, instead of a house of representatives of the people. It is a league of nations and not one big union, as the Knights of Labor was and as the Socialists would like to be.

For this very reason such a council excludes all political parties and substantially all radicals. These two elements get in mainly through the local city assemblies, which, however, have but one vote each, whereas the executives, who are always the controlling delegates from the international unions, cast altogether several thousand votes. This arrangement is a safety valve and a muffler. I have heard in these conventions the most radical and eloquent outbursts from delegates of these local assemblies; then a short reply by Gompers or an executive; then a vote of ninety-nine to one against the local irresponsibles. No wonder the latter and their sympathizers for forty years have denounced the Federation as a "Gompers machine." It is a "machine," just as modern capitalism is a machine. It is a strictly business and strictly conservative body, with,

however, an escape valve for grievances. How else can capitalism be met except by a "machine"?

But is it a "Gompers machine"? Herein is where I think Gompers showed greatness and fitness. Gompers, as President of the American Federation, never had authority to call a strike, or make a settlement of a strike, or control the funds of any nationally organized body of labor. He and his Executive Committee did have authority to appoint a limited number of local organizers, who helped all the unions in their membership campaigns and their strikes, and he did have authority over a very small and shifting number of local unions in occupations where no national union as yet existed. Otherwise the power of Gompers was only "moral," a term which, in his interpretation, signified the organized consent of collective action on which the American Federation of Labor was founded.

"PERSUASION, NOT FORCE"

Moral influence meant the belief that drastic methods would not bring education and solidarity; that it was persuasion, not domineering, that unionized. One of the national unions had disciplined a radical agitator, whose rebellious following broke up the union's meetings. The national officers, in despair, called in Gompers. He announced his intention of sending for the revolutionist. The officers protested. Discipline was at stake. Why recognize rebellion? But Gompers talked with the rebel and the union was again united.

On the other hand, no "dual union" can be admitted to the Federation. There must be but one union for all North America for each trade or industry. A thousand independent unions are eligible to the British Trades Union Congress. The American Federation of Labor admits less than 150. In England, as Dr Perlman has pointed out, there is a class psychology which unites all the unions against all the employers. But in America dual unionism means that either one or the other union furnishes strikebreakers for the employer. Gompers's "moral influence" with the executives of each national union was founded on their knowledge that no dual union would be allowed to displace them. Dual unions did arise, and some of them became powerful. Gompers was not always able to bring them together. But he did not yield to them.

In another direction "moral power" was Gompers's substitute for the weakness of labor in competition with business men. He had seen in New York scores of cooperative stores, cooperative workshops and other cooperative business enterprises undertaken by the unions, especially of the Knights of Labor. These "substitutes for capitalism," as they hoped to make them, broke down under the incapacity of organized labor to enforce discipline when it became the employer of labor. No one understood better than Gompers the limits beyond which the organization of labor could not go. It could not lift itself as a body out of manual labor and become a body of business men or professional men. For this reason Gompers was always against "theorizers" and "intellectuals" in the organization of labor. They were "industrially impossible." Amid all the differences in America of religion, of race, of language, of politics, there was only one direction toward

which labor could unite—more wages, more leisure, more liberty. To go further than this was to be misled by theorists, idealists and well-meaning but "fool" friends of labor. Labor could have "moral power" only when it struggled for better homes, better living, better citizenship, by its collective action. In the exposition of this point of view Gompers was the best of theorizers and the greatest "intellectual" of them all.

FIGHTER TO THE LAST FOR LABOR

It was this firm conviction that labor never could displace the capitalist in the management of business that made it possible for Gompers to enter into negotiations with capitalists, and even to disregard the outcries from his own ranks against his membership in the National Civic Federation along with the most noted, and even alleged anti-unionistic of capitalists. Gompers held that labor was always right. Up to the very last ditch he defended and appealed for help, even for those who afterward were convicted of dynamiting and murder. This may seem like a paradox to many, but this policy of his was merely the result of an experience with the courts gained in boyhood and during the collective struggles of organized labor and his belief that misrepresentations, false accusation and misuse of the courts all too frequently occurred.

Yet I have never known any one, whether labor leader or not, more reasonable in all his negotiations with employers, nor more ready to correct the methods of those he represented. He was simply, first, a fighter for the rights of labor, then a reasonable man in the use of those rights.

He knew full well the weakness of labor in business, and he knew equally well its weakness in politics. He penetrated the underlying fact of American political parties, that they are great, cooperative institutions of professional politicians and bosses competing for control of government and political jobs, and not organizations of citizens based on principles of public welfare. Organized labor never could compete with these unions of political experts, and a labor party was, at least in this country, as politically impossible as producers' cooperation and socialism were industrially impossible. What, then, should organized labor do in politics? Simply bargain collectively with these political unions, just as the capitalists bargained collectively with them. And what should it bargain for? Simply for immunity from interference by Legislatures, courts and executives, so that it could use its own collective moral and economic power to bargain collectively with the capitalists.

This may seem to be a very materialistic policy, but it is a part of the process of adaptation to American conditions. And when the great crisis came and the future of American independence hung in the balance, Gompers was equipped and ready, more than any other American, to lead American labor of the defense of American institutions, and he was buried with a military escort from the American Army.

When I last saw him, two months ago in Chicago, the mark of death was plainly upon him, but he was intent, as usual, upon his work. I asked his secretary if Gompers was not sick. "No, not sick," he said, "same as ever." His last great work—that of uniting Mexico

to America in bonds of labor and friendship—was then unfinished, and he died at the age of seventy-four “in the saddle,” a fighter for humanity to the last.

The philosophy of forty years of service was compressed into his dying words, “God bless our American institutions. May they grow better and better.”

28 THE STABILIZATION OF PRICES AND BUSINESS[1]

American Economic Review 15 (March 1925):43–52.

The resolution adopted by the Federal Reserve Board in April, 1923, is, in my opinion, the most important statement of policy since the enactment of the Federal Reserve law in 1913. The resolution reads: "That the time, manner, character, and volume of open-market investments purchased by federal reserve banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation."[2]

The significance of this resolution is not limited to the open-market investments of the reserve banks, as mentioned, but must include the other two great instruments of stability possessed by the banks, the rate of rediscount and the issue of federal reserve notes, for the three are tied together inextricably in any effort of the board to pay attention to the "effect" of their policies on the "general credit situation."

The further significance of this resolution lies in three directions, first, a comparison with the Federal Reserve act itself; second, a comparison between what the reserve banks did in 1919 and what they did in 1923; and, third, a comparison with the resolution adopted by the American Bankers' Association at their convention in September, 1924.

First, as to the Federal Reserve act itself. When the draft of that bill was introduced in the House of Representatives it contained a provision that the rates of discount should be made with a view not only to "accommodating commerce," but also to "promoting a stable price level."[3] But this was changed in committee and when the final bill was enacted into law the provision for promoting a stable price level was omitted.

I take it, now, that the phrase "general credit situation," adopted by the Federal Reserve Board in April, 1923, as a "primary" purpose of the reserve banks in governing their open-market investments, is equivalent to the deleted phrase of the original bill, "promoting a stable price level" in governing their rediscount rates.

And the substitute is perhaps superior to the original, in two respects. In the first place, the public generally, and the bankers particularly, would have been alarmed, in the year 1913, had the authority been granted to this new engine of concentrated banking to regulate prices. In fact, that idea, in the first draft of the bill, of a general average price level represented by index numbers, in contrast to the particular prices of particular commodities, was eight years in advance of the spectacular rise of the general price level which culminated in 1920 and slumped in 1921. People in general do not learn a new thing by reason and theory; they learn it by hard knocks. And even yet it is very doubtful

whether the public, or the bankers, can ever be brought, by mere education or research, to understand the distinction which most economists readily make between a general price level represented by so abstract a concept as index numbers, and the movement of concrete, particular prices back and forth across that abstraction. And especially, when it is proposed to entrust a new and great semi-monopolistic agency with power to regulate that abstraction, then the public generally and the bankers particularly cannot divorce themselves from the idea that what is intended is the regulation of the particular concrete prices of particular commodities. It is the latter that are the all-important thing for them, since it is these concrete prices, and not abstractions, which determine the profits, wages, and prosperity of each particular man in his own particular, concrete business.

The dread of creating, by act of Congress, such a power of price regulation concentrated in the hands of a small body of men, is perfectly natural. It is natural to expect that each particular farmer or business man would suspect that, if his particular prices slumped downward, the Federal Reserve Board and reserve banks had come under the influence of people whose prices had boomed upwards, or at least not slumped, and that the remedy lies in getting political control of the board so as to discriminate in a different direction.

In view of these considerations it is probable that those of us who have directed our attention towards stabilizing the general level of prices have been premature. We have set up a statistical abstraction for the guidance of money and credit, and, while I believe that that abstraction is the most important criterion with which the public and bankers should become acquainted, yet I concede that the Federal Reserve Board showed wisdom, in the present stage of public thinking, when it substituted the phrase "general credit situation" for the phrase "a stable price level."

Yet there is no more important duty imposed upon economists than that of familiarizing the public with the concept of a general price level. Much misleading advice is given, even from governmental headquarters, through failure to make the distinction between particular prices and the general price level. The Federal Trade Commission, for example, in 1920, replying to an inquiry from Congress as to why the price of petroleum products (gasoline) had so greatly advanced, devoted fifty-seven printed pages to a solemn explanation of that *advance* in price, but never once mentioned that, compared with the rise of the general price level, the price of gasoline had actually *declined*.[4]

It is also on account of failure to make this distinction that it has come almost to be accepted that the Federal Reserve Board and reserve banks should conduct themselves with regard to the effect of their policies on government financing, instead of the effects on the general price level, and that particular classes in the community should have representation on the board and the reserve banks in order to safeguard the prices of their particular products. These dangerous tendencies arise, I believe, from the failure of the public to distinguish between a general price level and particular prices. It would seem to be no part of government financing to disturb the general price level, and no part of any particular class to manipulate the general price level with regard to its particular prices.

In view of this general lack of understanding, it is no wonder that the Federal Reserve Board, which evidently knows the distinction between a general price level and particular prices, should hesitate to base its policy upon that distinction.

Yet we know very well, from bulletins of the Federal Reserve Board and the district reserve banks, that those authorities do actually take into account the changes in the

general price level as a highly important—perhaps the most important—element in what they designate "the general credit situation." They have constructed sensitive indexes of price movements which serve as forecasters of the general credit situation, and they have also incorporated other indexes, such as volume of production, volume of trade, volume of employment, and so on, all of which are needful both in the problem of forecasting and in the problem of deciding just what shall be the "time, manner, volume and character," as they say, not only of their open-market investments, but also of their rediscount and note-issue policies.

No economist has ever held that the general level of prices can be exactly stabilized. There will always be fluctuations of the general level up and down, even with the most perfect stabilization of prices. What is really meant by stabilization of prices is in fact merely the stabilization of "the general credit situation," so as to avoid only the excessive peaks and excessive slumps of the general price level. And this, we may say, has been the effect of the policy of the Federal Reserve Board and banks since the adoption of the resolution of April, 1923. They have, since that date, accomplished as much towards stabilizing the general price level as they could have done had they been operating under instruction from Congress as contained in the first draft of the bill.

This policy, since April, 1923, is to be contrasted with the highly different and highly disastrous policy of 1919 to 1921, when the Reserve Board did not guide itself by a policy of price stabilization, much less by a policy of credit stabilization. There were undoubtedly, as we know, experienced bankers on the advisory boards and reserve banks in the spring of 1919 who saw what was coming through the low rates of rediscount, the large purchases of securities and the multiplication of federal reserve notes at that time. But they had no sufficient influence in the face of the dominant place on the board held by the Secretary of the Treasury, who felt himself compelled to float the new issues of government securities at less than the current rates of interest on the commercial and investment markets. Not until those issues were disposed of, in the fall of 1919, were the board and reserve banks free of this influence of the Secretary of the Treasury, and then a few halting and belated steps were begun, designed to counteract the inflation which had been started in the spring of the year. But it was too late, and the boom went on to its collapse in 1920. Had the government offered higher rates of interest on its certificates, or had it been willing to sell the certificates at less than par, then the Secretary of the Treasury would have permitted the Reserve Board and the banks to make timely advances in the rates of rediscount and to refrain from investing in open-market and government securities, and to refrain from the excessive issues of federal reserve notes. But the secretary's ambition to make a successful record in the patriotic policy of floating enormous loans at low rates of interest, prevented the board and banks from doing what, as experienced financiers and bankers, they knew should have been done at the very beginning, or in the early stages, of the rise of prices and inflation of credit.

There was added also the eagerness of member banks in lending to Europe on the hope of rehabilitation, and the policy of the board and banks could not resist helping out this laudable optimism. Had the board adopted in April, 1919, the resolution which it adopted in April, 1923, and had it and the reserve banks applied the resolution to the rediscount rates as well as the open-market operations, then the extreme inflation and collapse of world credit in 1919–1920 would not have occurred, or would have been far less extreme. When the thing was once under way, then only the most drastic remedies could be

invoked, and the sale of securities and final excessive advance of the rediscount rates, forced upon the banks by the danger line of the gold reserve in 1920, was the penalty of *not* governing themselves soon enough with “primary regard,” as they now say, to the “general credit situation.”

Then, when the collapse came in 1920, the board and banks continued their sale of securities and kept up their high rate of rediscount, long after the “general credit situation” had clearly demonstrated the need of renewing purchases and promptly reducing the rediscount rates. Had they been acting in 1919 and 1920 upon the resolution of April, 1923, they would have begun to raise the rediscount rates and reduce the open-market holdings in 1919, several months before they actually did, and again would have reduced discount rates and increased open-market holdings in 1920, several months before they actually did.

Again, a comparison of what happened in the spring of 1923 with what happened in the fall of 1919 and spring of 1920 will show how easy it is to stop an inflation when the board and banks begin soon enough. During several months preceding February, 1923, prices had been advancing at a rate almost as rapid as the first advance in 1915 and the second advance in the spring of 1919. The board and reserve banks were giving close attention to the matter in 1923, knowing quite well what they ought to do, but not knowing exactly when, nor in what degree, nor in what volume, nor how extensively over the entire country, they ought to do it. This question of timeliness is indeed almost the whole question of a responsible administrative authority, like the Federal Reserve Board and the reserve banks, just as it is the important question deciding the success or failure of every business man. Gold was coming into the country in large quantities. The prospects of inflated prices were even greater than they were in the spring of 1919. But now, however, in February, 1923, a slight rate advance was made by three reserve banks, a slight amount of sales and liquidation of loans was made by the reserve banks, beginning in January and February, and to this was added warning by the United States Secretary of Commerce, by some of the forecasting agencies and trade associations, and in the monthly letters of leading banks.

Almost immediately, in all parts of the country, the open-market operations of the reserve banks and the warnings of a rate increase by only three of the banks had general effect. The balances of member banks at the reserve banks began to be reduced, and it was discovered, now that substantially all the gold of the member banks had been impounded by the reserve banks, that it was the sale of investments by the reserve banks that offset the influence of the gold imports. These sales and liquidations of loans had almost an equal effect on the ability of member banks to extend loans to business men that a similar export of gold would have had, and the slowing up of the commercial loans occurred in substantially all parts of the country. Then, in April, 1923, the board adopted the formal resolution, above stated, expressing in words what it had actually been doing for three months previously.

Here it was revealed, to the astonishment of many, that the enormous gold reserves and gold imports of the country, while all other countries were on a paper money basis, nevertheless need not have the effect of raising gold prices in this country. As a matter of fact, it might almost truly be said that, since that date of April, 1923, we have not been actually on a gold basis, but have impounded our gold beyond the use of the banking system, and have stabilized prices at something much lower than the gold level. And this

was done with just a slight and delicate touch on the two great levers in the hands of the reserve board and banks, the lever of the rediscount rates and the lever of the open-market investments.

I do not say that such slight and delicate measures would have accomplished as much in the spring of 1919. The country, then, was under the impression that we were making up the losses of the war, and consumers were eager to purchase; but in 1923 business men had vividly in mind the sufferings of 1920 and 1921, and hence only delicate hints were enough to make them cautious. Yet this only goes to say that stronger measures might have been necessary in 1919. Many economists, bankers and business men now believe that if the rediscount rate in this country could have been raised to 7 percent, or possibly to 8 percent, in the spring of 1919, a large part of the subsequent boom and collapse might have been avoided. Thus it might have required an increase of 4 or 5 percent in the discount rates of 1919 to accomplish what half of 1 percent at three reserve banks accomplished in 1923. It is, again, the question of timeliness—knowing when, how much, and how far to employ the instruments in their possession.

Now, however, at the opening of 1925, no one can say that this admirable feat of 1923 can be repeated under the conditions of continually increasing gold imports which are relieving member banks from direct and immediate dependence upon the reserve banks. And I think the Federal Reserve Board and the reserve banks must have been astonished at the ease with which the stabilization of the credit situation was effected. If anything, they overdid it, and the business activity of the ensuing period has not been as lively, nor the prices of products as steadily maintained, as one could have wished who hoped for a stabilization of the price level. The decline, in fact, became rather serious in the first half of 1924, but since that time three reductions in the rediscount rates have been made at New York, and lesser reductions elsewhere, so that, along with open-market investment purchases and other circumstances, a considerable enlargement of business and a rise, especially in farmers' prices, has occurred. Meanwhile, the reserve banks have been increasing their investment and open-market holdings, and, perhaps, they may be in a favorable position to check the present recovery of prices before it develops into another inflation.

The third comparison which I wish to make respecting the resolution of April, 1923, is that of the action of the American Bankers' Association at their convention in September, 1924, which appears to me to be a serious menace against the stabilizing influence of the federal reserve system, and eventually against the continuance of the system itself. The bankers complain that the federal reserve system now furnishes service of various kinds, without charge, which has resulted in "an unduly increased overhead," and that, "in order to earn expenses and dividend charges" they "compete for business with their own member banks in such fashion that there is danger that in the future the operations of the federal reserve banks may tend to accentuate the swings of the financial pendulum rather than to keep the swing of the pendulum from going too far in either direction." The bankers then go on to suggest that it may "be wise to limit the federal reserve banks to their primary function as banks of issue and rediscount."

This resolution is quite in line with a previous statement of the Federal Advisory Council of bankers addressed to the Federal Reserve Board in January, 1922, to the effect that

> the federal reserve system…must not be permitted to deal with customers direct and thereby incur the risk of immobilizing its funds in credit that may conceivably be frozen. Whatever relief the federal reserve banks may furnish must, therefore, be granted through the intermediary and under the responsibility of banking channels.[5]

These resolutions are, of course, directed mostly against the open-market purchases and sales of the federal reserve banks, and they go on the assumption that those purchases are made, just as a private bank makes its purchases, for the sole purpose of investing its surplus funds in order to enlarge its profits or reduce its losses. But these resolutions overlook the public purpose of the federal reserve system, as contemplated in the act of 1913[6] and make that system subordinate to the private profits of member banks. Quite the opposite is the policy followed since April, 1923, of governing their open-market operations, not solely in order to make a profit, but mainly in order to safeguard "the general credit situation." Prior to the establishment of the reserve system, the only weapon by which overextension of credit and undue curtailment of credit and banking accommodations could be met, was the interest rate, but changes in the rate upwards came too late to check overexpansion, and changes in the rate downward came after the disaster of a panic. Now, with the central organization, the rediscount rate comes in with the possibility of changing it in advance of disaster, or making it more effectual in time of depression, and thus warding off or mitigating the excessive fluctuations.

But the open-market operations are a more efficient and smooth-working device than the rediscount rate, simply because they make it possible for the reserve system to take the initiative and not to wait on the member banks in order to furnish or withhold the supply of funds to the market.

The situation is simply the old and familiar one of the functional relation between supply, demand, and price of any commodity. The commodity, in this case, is credit, or more exactly, it is the supply of purchasing power created and loaned by the banks to the public at a price, which price is the rate of discount. The federal reserve system has now been created by the public to hold the balances of the member banks and to rediscount and issue notes in order to protect the public against the unregulated activity of the banks in their purely private competition for profits. Perhaps the idea uppermost in the minds of many persons at the time of the enactment of the law was only the prevention of panics and general deflation of prices. If so, it was a failure to realize that the prevention of a collapse of credit can be fully accomplished only by preventing the previous competitive inflation of credit. This was evidently the view of the framers of the act[7] and this is what the resolution of April, 1923, recognizes.

The Federal Reserve Board and reserve banks, in order to accomplish their purpose, must have an influence not only on the *price* of credit through rediscounting, but also on the *supply* of credit through direct open-market operations with the public. Sometimes the stabilizing influence of the board is accomplished by regulating the *price* of credit which may then indirectly affect the supply and demand; sometimes by regulating the *supply* of credit, which may, in turn, affect, the price and demand; and all of this implies knowledge and forecasting of the way in which supply and price are related to the *demand* for credit under the changing circumstances of time and place. Instead, therefore, of weakening the board's regulation of *supply* of credit and limiting it only to the *price* of

credit, the public interest, as against the supposed private interest of bankers, would indicate, that the open-market operations of the reserve banks should be enlarged rather than diminished.[8] Only in that way can the public purpose expressed in the resolution of April, 1923, be fully accomplished.

This attitude of the bankers in putting uppermost their private profits is similar but opposite to that of many borrowers and debtors who think that the test of the success of the reserve system is in keeping down the rates of interest and increasing the supply of credit. But, if we are to have stability of the general credit situation, which means relative stability of the general price level, then we cannot have stability of the rate of interest on money. We cannot have *both* cheap money *and* a stable price level. We can only have one *or* the other. We must choose the one that is the more important for the welfare of the country. If we want a stable price level with its stable credit situation, we must first *raise* the rate of interest at commercial banks in order to moderate or prevent an inflation of credit and prices, and then *reduce* the bank rate in order to moderate or prevent a deflation of credit and prices. In short, the rate of interest, backed by open-market operations, is the crucial factor in the business mechanism; and, therefore, in order to accomplish this regulation, the interest rate must not only swing strongly in the opposite direction to business tendencies, but must do so several months before these tendencies have developed into inflation and deflation.

The present situation in this country is anomalous. The imports of gold from abroad have been enormous and we have protected ourselves by impounding the gold in such a way that the reserve requirements of our banks have lost the significance they formerly possessed. Furthermore, the demand of the public and the administration regarding the collection of European state debts owing to us is certainly far beyond the capacities of those countries to pay us in commodities and services, and even should they try to pay us in commodities we would raise our tariffs to prevent it. With such a short-sighted, greedy attitude towards our former allies, it seems that we are to continue importing gold to such an extent as to make our banks more and more independent of the federal reserve system, and to confront us continually with the possibility of disastrous booms and collapses.

It is possible that a continuance of the present rate of increase in the present American price level will bring the purchasing-power parity of the currencies of England and America nearer together so that the pound sterling will attain its par value in terms of dollars. The same might be effected by a decrease in the British price level. Part of our surplus gold might then possibly move to England and the two countries would reach the old condition of a free movement of gold. But if the other countries of Europe begin to pay interest and debts, as England is doing, then an added strain will be placed upon sterling in favor of dollars, and the effort to restore its value to par will be defeated. If sterling does not return to par, much less will the franc, unless either our price level rises or the French level falls, or France devalues her currency as Germany has done.

Even in such case the continuous strain on Europe for debt payments to America makes it difficult to see how it will be possible, during the many future decades of those payments, to reach again the free movement of gold both ways, which is essential to a return to an international gold standard. With such a prospect before us, we have only the federal reserve system to protect the stability of our price level and our volume of credit. The resolution of April, 1923, probably goes as far as the present law permits. The future is not promising, but the next step is evidently some kind of an international

understanding—even a bold cooperation of our federal reserve system with the banking systems of other countries, in order to work out, for the world as a whole, not only a stabilization of the "general credit situation," but also of the general gold situation.

NOTES

1 The first of three papers read at the Thirty-seventh Annual Meeting of the American Economic Association, in Chicago, December 30, 1924, on the general subject of "The World's Monetary Problem."

2 *Federal Reserve Bulletin,* May, 1923, p. 543.

3 H.P.Willis, *The Federal Reserve System* (1923), pp. 1985, 1605–1626.

4 *Report of Federal Trade Commission on the Advance in Price of Petroleum Products* (1920), 66th Cong., 2nd Sess., House Doc. 801.

5 Quoted by Anna Youngman in *American Economic Review,* vol. XII (September, 1922), p. 435.

6 Willis, *op. cit.,* pp. 331, 332.

7 Willis, *op. cit.,* p. 332.

8 Cf. article by Anna Youngman, "A Popular Theory of Credit applied to Credit Policy," *Am. Econ. Rev.,* vol. XII (September, 1922), p. 417.

29
THE TRUE SCOPE OF UNEMPLOYMENT INSURANCE

American Labor Legislation Review 15 (March 1925):33–44.

Adam Smith advanced the proposition, 150 years ago, that "wages of labor in different occupations vary with the constancy or inconstancy of employment." He gave two reasons for the higher daily wages of inconstant employment: first, the need of a reserve for the period of unemployment, and second, as he said, "some compensation for those anxious and despondent moments which the thought of so precarious a situation must sometimes occasion."

His first reason seems to have arisen from his idea that the annual earnings of all laborers of similar skill and hardship are normally about the same, and consequently the daily wages must vary inversely to the constancy of employment. His second reason seems to be a special case of his similar proposition that wages vary inversely to the agreeableness of the employment.

Smith had in mind unorganized laborers in a freely competitive or, what he called, a "normal" market. Compare, however, Smith's simple ideas of a normal market with the complex situation of a modern large manufacturer in a strongly unionized district in the United States, competing with unorganized establishments in other districts. Such a manufacturer has recently written as follows:

> A large part of our work is done by piece workers, and the prices are so large that, if steady work is furnished, the men earn very large pay, but for several years just passed, work has not been steady. The demand for goods in this section has fallen off materially, and in consequence the workmen get employment only a fraction of the time. In order to meet this situation in the past, wages have been advanced several times with the idea. I suppose, that if employment is not steady, remuneration must be sufficient to carry the workmen over the dull periods. It has always been the policy of our company to provide steady employment, and we have furnished this to our employees for the past thirty years, but they have now put the prices so high in this district that we cannot successfully compete with other centers, and we shall have to run part time, as the

> others do, or discontinue our business in this locality. Some manufacturers whose capital is limited and whose factory facilities are ample, deliberately shut down their plants until about the time their goods are wanted, and then start up and run full force for two or three months and then close down again. We do not care to do business in this manner. We wish to run steadily, and in this way reduce our overhead, make close prices, and keep the orders coming. This we have been able to do in the past, but at the present moment the outlook is rather unfavorable for a successful continuance of this policy.

And this employer goes on to ask whether some form of unemployment insurance or guaranty of steady employment might be adopted that would be acceptable to the union.

Here, we can see that this modern manufacturer is confronted by three facts that Adam Smith did not contemplate in his simple scheme of normal competition, namely, overhead costs, business cycles and organized labor. Such other factors as seasonal employment, labor turnover, and the pain of anxiety, were given due weight by Adam Smith, but he doubtless would have considered, 150 years ago, that business cycles and organized labor were abnormal and that overhead costs were negligible.

SIGNIFICANCE OF BUSINESS CYCLES

The significant fact about business cycles is that they upset many of the calculations of the economists, from the time of Smith to the time of marginal utility, as to what is “normal.” They are, indeed, a normal abnormality of the nineteenth and twentieth centuries. And the pertinent fact about business cycles is the “lag” both in time and in amplitude of daily wages received by laborers compared with the prices received by employers for the product of that labor. Organized labor tends to reduce this lag by boosting daily wages faster and higher during the rise in prices and holding them up longer and higher during the slump in prices, but apparently, the new restrictive immigration policy of the United States is permitting unorganized labor to imitate organized labor in this respect. Consequently, in addition to the higher daily wages that Adam Smith attributed to seasons, turnover and anxiety, modern labor, both organized and unorganized, demands and gets a higher daily wage on account of the business cycle.

Furthermore, the principle of overhead costs applies to labor as well as to capital. For overhead costs are simply the costs that go on continually, regardless of the amount of product. Labor’s overhead cost is the cost of living several years in succession instead of living only while employed. This was taken into account by Adam Smith. But capital’s overhead cost is the cost of fixed charges for maintenance, interest and even dividends, regardless of seasons and cycles. Of course, it is obvious that the greater the overhead cost per unit of product, the greater is the cost of manufacture, and that both capitalists and laborers will shift this cost to the ultimate consumers, in the form of higher profits and higher wages, if they are in a position to do so.

But the term "ultimate consumer" is merely the obverse of "ultimate producer." The ultimate consumers of one product are the ultimate producers of other products, through the process of exchange. Each person is both ultimate producer and ultimate consumer, and what each loses as consumer, in the high cost of products purchased, is augmented by what each loses as producer in the loss of business and employment. The two losses, however, do not occur simultaneously. There is a lag, conforming to the pertinent fact of the cycle. Apparently, however, if the three uncertainties and anxieties, of cycles, seasons and turnover, could be reduced or eliminated, the cost of products would be reduced for consumers by the very process of making business and employment steady for producers.

Take, first, business cycles. The primary feature of a business cycle is not so much irregularity of employment, nor even, indeed, a uniform cycle of business and employment, like that of a wheel, or a wave of the ocean, or the tides, but is any circumstance that changes the general purchasing power of money up or down over a long, short or sudden period of time. The business cycle is really a trend, a cycle and a jerk. Causes of these changes are found in the standards of legal money and in the standards of banking policy and taxation, relative to the world's volume of business transactions. A world war, a mistaken bank policy, a change in the mint price of gold or silver, a change from silver to gold or paper money, a change in tariffs, a change in the world's quantity of business, all of these influences produce a trend, cycle or jerk, in the general purchasing power of money.

Money, in fact, measures the relative scarcity of all products compared with human wants, just as other units of length, weight, capacity, horse-power, or labor power, measure the physical quantities of commodities or output regardless of wants.

Every business transaction employs two units of measurement, a scarcity unit in terms of legal money, and a quantity, or efficiency, unit in terms of legal or customary ounces, bushels, yards, output, and the like. If either one of these two sets of units should gradually or suddenly change its dimensions, then all of the phenomena of trends, cycles and jerks would occur. If all the units of physical measurement, such as yards, bushels, ounces, output and so on, should gradually be increased in size, say 10 percent, for example, by some unseen hand like the sunspots, or transits of Venus, or a bureau of standards at Washington, then every producer would have to produce something like 10 percent more of his product in order to get the same quantity of money in exchange and thus to pay his debts; so a business depression would set in, just as it does now when the physical units are constant but the scarcity unit, money, increases its purchasing power. A general fall in prices is but the inverse of a general increase in size of the physical units of measurement.

Governments have accurately stabilized the various physical units, but have not stabilized the scarcity unit. Without this stabilization an entirely false notion is given of a general scarcity or general oversupply of products. A general rise in prices gives the notion of a general scarcity and this gives a notion of general prosperity, and this leads and even compels all business men to a general over-accumulation of inventory, plant and labor; whereas the appearance of general scarcity and prosperity was actually only a decrease in the size of the scarcity unit, money, as compared with all of the physical units of measurement. And a general fall in prices gives the appearance of a general overproduction and depression of business and leads, and even compels, all business men to restrict production, to unload their inventory and to lay off employees; whereas, this

false appearance of general overproduction was only an increase in the ratio, that is, the purchasing power, of the unit measure of scarcity compared with the physical units of measurement.

ILLUSIONS OF “GOOD” AND “BAD” TIMES

It is evident that no individual employer and no association of employers can cope with this gyration of the purchasing power of the scarcity unit. In a condition of rising prices they are compelled to bid against each other for materials and labor, and in a condition of falling prices they are compelled to sell before their competitors do, if possible. The psychology of business augments the gymnastics of money. I take it that recent economic theory has shown, based on the actual practices of central reserve banks and the practices of business, that it is possible to stabilize the purchasing power of money—not as accurately, of course, as the physical units of measure are stabilized, but adequately to overcome the false notion of general scarcity and the subsequent false notion of general overproduction, with their false appearances of prosperity and depression which the vacillating measures of scarcity imposes on the business world.

But while this stabilization is possible it, will not be accomplished until the three classes in the community—employers, employees and farmers—who suffer most have become united enough to bring sufficient pressure upon politicians and bankers to require them to do what they already have the power to do.

Such concerted pressure, we know, comes about indirectly or negatively, through a more or less blind mass psychology, provided that psychology rids itself of certain strategic illusions. The primary illusion that has to be dissipated, in this case, is that of the false prosperity of a condition of rising prices, created by the illusion of general scarcity. When all labor is fully employed (allowing for a necessary turnover) then any additional general rise in prices or wages is the illusion of general scarcity which produces the illusion of prosperity. It certainly is not an illusion from the individual standpoint. It is an illusion from the social standpoint, because it is the speculative process of taking wealth from other people by a raise or lag in the levels of prices, and not the industrial process of increasing the total amount of wealth. If this illusion of social prosperity is dissipated, it will automatically dispel the subsequent illusion of overproduction.

There are some indications that this illusion of prosperity is being abated. In the summer of 1919, I found the clothing manufacturers of New York paying as high as $125 per week for off-pressers where the union scale was only $50 per week, and the pre-war scale had been scarcely $25 per week; and the employers were actually practising deception upon the union which was trying to prevent its members from leaving one employer in order to work for another at more than the union scale. In the same summer, in one machinery establishment, money wages per hour had increased three-fold, but the product per worker had decreased two-thirds. In another establishment truck drivers, who met with accidents on the street, abandoned their trucks and found other jobs, rather than

stop to repair their trucks. Labor, organized and unorganized, during that peak of false prosperity, had acquired four things under the illusion of general scarcity, namely, high daily wages, short hours per day, reduction of output, and general irresponsibility.

Then came the downward jerk in prices with its accompanying social illusion of overproduction. Laborers lost, during many months of idleness, as much as they had gained, or more, by the high wages and short hours that could not be maintained when prices slumped. And they lost by the concerted action of employers and courts in breaking down the unions, "liquidating labor," as they said, and starving the workers into greater output per hour. Evidently the slump in prices and the class struggle over wages and employment were but the necessary reaction from the preceding illusion of social prosperity and general scarcity.

I believe that this recent and vivid experience has directed many of the leaders of labor and business to the importance either of smoothing out the curve of employment or of smoothing out the curve of annual income. These are two related but different problems. Take the latter first.

STABILIZING ANNUAL INCOME OF WORKERS

Assuming that the cycles, trends, jerks and seasons are to continue, then the smoothing of annual income prescribes the remedy of setting aside reserves, during the period of apparent scarcity and false prosperity, in order to pay wages during the period of apparent overproduction. Whether these reserves shall come out of wages or out of profits, it is difficult to determine. If they are paid out of profits they reduce, by so much, the income taxes and consequently are not quite as heavy a burden on the employer as their aggregate amount might indicate. At the same time, it is well known, and was, indeed, one of the assumptions of Adam Smith which I have mentioned, that laborers will accept lower wages per day if they have assurance of steady employment at steady wages than when they have no assurance of such. This principle was taken advantage of in the inauguration of the unemployment insurance system of the men's clothing industry of Chicago. The arbitrators granted a raise of 10 percent in wages, but the two parties stipulated that only 7 percent should be paid currently in wages, and that the other 3 percent—paid half by the employers out of profits and half by the workers out of wages—should be set aside for unemployment insurance. What actually happened was that the workers accepted a 7 percent increase in current wages instead of a 10 percent increase, on the condition that an additional 3 percent should be taken in the form of deferred wages during unemployment.

I cannot say, from this experience, what would be likely to happen if the 10 percent increase in current wages were previously granted and it was then attempted to reduce it to 7 percent current wages and 3 percent deferred wages. It is evidently much easier, as a problem in mass psychology, to take away 3 percent that the workers had not yet received than to take away 3 percent that has already been going into their pockets every week.

The one is a disappointment, the other a bereavement. But even the disappointment cannot go too far, as is shown by the fact that the workers' union, in this case, at first proposed to take 4 percent instead of 3 percent for unemployment insurance, but found that, in order to maintain peace among the sections within the union, it had to make a few advances in current wages to low paid sections which thereby reduced the insurance premium from 4 percent to 3 percent.

If such is found to be the difficulty when the unemployment reserve is taken out of an increase in wages at the moment when the increase is granted, much greater would be the difficulty in taking it out when the actual decrease in current wages is required in order to take it. In the latter case it would seem to be coming solely out of wages whereas in the former case it seems to be coming mainly out of profits. Yet, in both cases it is impossible and wholly speculative to say whether it comes more out of current wages or more out of current profits.

In any case, I do not see how much progress can be made if the problem is stated in this form of a class struggle between the employer and employee. The proper way of stating it seems to be as follows:

Modern industry must bear two kinds of overhead—capital overhead and labor overhead. Each is equally entitled to consideration, and it is a matter of adjustment, or bargaining, or ingenuity, in each particular establishment or industry, at each particular time and place, to determine how much shall be declared currently in dividends and wages and how much shall be carried over for deferred dividends and deferred wages.

This community of interest, instead of class struggle, will become apparent if the attention of both parties can be directed away from the problem of smoothing out annual income of the workers, to our second problem of smoothing out employment. The former consists in paying workers while they are idle, the latter consists in reducing idleness. The former is class struggle, the latter is joint increase in the efficiency of industry. The former is relief for the unemployed, the latter is prevention of unemployment. And the latter will give the larger annual income.

STABILIZING EMPLOYMENT

In considering the problem of prevention, a curious paradox confronts us. Large establishments have presumably a much larger item of overhead relative to the number of employees, and this overhead would seem to intensify the inducement of large-scale industry to make greater efforts to smooth out production and thus reduce the overhead costs per unit of product. Yet the investigation made by the National Bureau of Economic Research reveals the fact that, in the depression years 1921 and 1922, on a total enumeration of 4.1 million employees removed from the payrolls, the establishments having twenty or less employees laid off only 3 percent (2.64) of their employees; the establishments having twenty-one to 100 employees laid off 15 percent (14.56); and the establishments having over 100 employees laid off 23 percent (22.78).[1] Other investigations do not show such great differences,[2] but, as far as it goes, it indicates not only a paradox, but also the focus for applying remedies. Practically all establishments of

twenty employees or less may be disregarded, or should be treated quite differently from those having twenty-one or more employees. And the paradox of employers contending that they do not need the additional incentive of unemployment insurance to stabilize employment, since the heavy overhead of industry is already an adequate inducement, falls to the ground. The cycle of employment and unemployment tends to increase, or, at least, not decrease, in amplitude as industry is concentrated in large establishments. In general, the successful employers are able, apparently, to take care of their capital-overhead by means of high profits at the peak and high reserves for the trough, but they do it by a system of speculative plunging on a rising market and then compelling their employees to take care of their own labor overhead on a slumping market.

Now if, the principle is set up that the industry should take care of both kinds of overhead, and that it should be done in the same way that the Boards of Directors already take care of their capital overhead, we shall arrive at three propositions:

1. Establishments having a small number of employees should be treated differently from establishments having a large number of employees. A suggested difference is that they should be organized in the form of mutual insurance companies.

2. Establishments having a large number of employees should each carry, as far as possible, its own risk, by way of setting aside its own reserve not merged with the reserves of other establishments in a common fund. They should NOT organize on the insurance principle.

3. The employees should not, ordinarily, be required to contribute to the fund out of their wages, the provision for reserves being handled by the individual establishments, or, for mutual insurance, by the associated small establishments; but if the employees do contribute, then THEIR contributions should be merged into a common fund on the insurance principle, so that all employees will benefit, no matter what firm they work for.

These suggestions are tentative, and it might seem that, after all, I have reverted to the plan of smoothing out the curve of annual income of the worker, whereas I am now supposed to be considering how to smooth out the curve of employment. My answer is solely this: the pecuniary motive is the only motive what will effectively do the work of stabilizing employment, and this is confirmed by observing how the matter has worked out, up to date, during the short experience in the Chicago men's clothing industry. The union wanted what they call a "market fund," by which is meant a common fund on the insurance principle, contributed by all the houses, and available for any of the 35,000 union employees in the Chicago industry, no matter in what house they might previously have been employed. The employers stoutly resisted the market fund idea and prevailed, in the end, by getting the union to agree on separate "house funds," that is, not insurance, but merely unemployment reserves, for each of the individual establishments.

ATTITUDE OF EMPLOYERS AND WORKERS

Here is quite evident the difference between the employer's psychology and the workers' psychology. The employer who can maintain relatively steady employment does not want to pay out his good money for the relief of workers employed by his competitors who do not maintain steady employment. Hence the successful employer wants the individual house fund which is his own reserve for unemployment for his own employees, and does not want a market fund which is a mutual insurance reserve available for his competitors' employees.

On the other hand, the union must take care of all of its members, no matter in what establishment they have suffered unemployment. The employer thinks of his competitors; the union thinks of its members out of work. The employers' psychology is the individualistic, competitive, business psychology. The workers' psychology is the mutuality and solidarity of those who rise or fall as a class and not as individuals out of the class. The employer wants no mutual insurance or state insurance scheme; the union's existence depends on mutuality. The employer survives by competitive efficiency and the weakness or bankruptcy of his rivals. The union survives by improving the condition of its less fortunate members, so that all may rise together. Consequently, when it came to the working out of the rules for actually putting into effect the collective agreement in the Chicago clothing industry, the mutual insurance principle forced its way into the rules, although not recognized in the collective agreement.

1. The small tailor contractors, some 200 in number, all of them having less than twenty employees each, had to be organized, for administrative purposes, into a mutual insurance association on the market fund principle.

2. The cutters, some 3,300 in number, of whom 3,000 were classed as "permanently" attached to a house payroll, and 300 as "temporary," that is, not attached to any particular house, had to reduce the amount of unemployment compensation received by the permanent cutters and to create a "temporary cutters' fund" for the whole market in order to carry the temporary cutters over twice as long unemployment as the maximum for permanent cutters.

3. Some of the individual houses went out of business or their periods of employment were so short that their house funds threatened exhaustion early in the game. Consequently, the union treasury had to prepare to come to the aid of the union members thus unemployed, but without any house fund to draw upon for unemployment benefits. Thus the union is virtually compelled to set up an additional market fund, not contemplated in the agreement with the employers, a fund contributed by all union members in order to supplement any individual house fund that falls short.

To these should be added:

4. The dissatisfaction and complaints from some of the employers in medium sized establishments, not able to command the credit required to stock up in off seasons and carry over to busy seasons, to the effect that they are discriminated against by the house-

fund principle and should, therefore, have a market-fund by means of which contributions from the biggest and most successful houses would fill up the gap of their own inability, through lack of credit, to stabilize employment.

It will thus be seen that only from the largest establishments and not from the smaller establishments, nor from the employer, nor from the state, can any material progress be made towards prevention of unemployment. The Huber bill, recently before the Wisconsin legislature, was drawn up on this principle. Establishments with good financial credit are permitted to carry their own reserves for unemployment. Other establishments are required to insure in mutual insurance companies, or otherwise. The employees are not required to contribute, but may of course voluntarily contribute, and the state government does not contribute, but merely sets up the legal right to a definite compensation or deferred wage, for lack of work, just as is done in the case of workmen's accident compensation, leaving the employer to finance his obligation as he may find most convenient. The state does only three things: sets up a legal liability for unemployment compensation, provides a registry of the unemployed, and decides disputes. The employers then finance their own liability as they may wish.

UNEMPLOYMENT INSURANCE AIDS STABILIZATION

This directs attention to the principle that, if unemployment insurance is to succeed, it must be accomplished, not by a different distribution of wealth, but by a larger productivity of industry. This larger productivity may be expected partly from the reduction of overhead costs per unit of product and partly by fitting the insurance or liability scheme, on the one hand, to the speculative, individualistic, pecuniary psychology of employers, and on the other hand, to the conservative, solidaristic, welfare psychology of workers.

Already in the Chicago clothing market, the initial effects of these inducements to greater productivity can be seen. Large firms have already cut down their peaks somewhat; the union, through its employment offices and its discipline of union members, is guarding against waste in the employer's business in order to enable the employers to get into markets and thus increase the steadiness of employment and the union is guarding against abuse of the benefit payments; but, most significant, the employers generally are taking seriously to heart the new standard of competitive success which turns upon their ability to smooth out the curve of employment, and are either stabilizing employment or explaining why they did not succeed in stabilizing it.

It cannot be said that these and other isolated projects which might be mentioned, have had or will have much effect in getting back to that fundamental cause of business cycles, such as the credit policies of bankers and of the reserve bank systems. They are only a few scattering indications of the increasing attention of the business and labor world towards the stabilization of industry. Yet the provision for compulsory reserves for unemployment, whether through union pressure or state pressure, may be said to be a

kind of specific remedy directed towards that outstanding fact of large-scale industry, namely, the control of industry by bankers, financiers and absentee boards of directors. I know of no way to reach these modern captains of industry except by way of the pocketbook. The modern pocketbook is the credit system. If the duty to pay for unemployment in the form of deferred wages is made directly a cost of industry, then we may expect the absentee pocketbook to convey to its owner a realizing sense of the importance of so regulating both the expansion and contraction of his own business and of the reserve banks as to provide a greater stabilization of industry in general.

Another limit to the scope of unemployment insurance may be said to be the Space limit. An individual establishment can not do much when its competitors are not brought in line; a single industry can not do much when other industries are boosting and slumping; even a single state of the American union can not go far when the American nation is holding back; and a single nation can not act effectively without the cooperation of other nations. Yet nothing will be done, either in credit stabilization or in employment stabilization if each establishment, each industry, or each state or nation, waits until the others begin. Beginnings must be made in spots, and then the laggards must be brought up to the level of beginners.

And so, if we conclude our inquiry as to how far unemployment insurance may be looked forward to as a means either of relief or of prevention, we can only say that, at first, the limits are very narrow and the barriers are very high, considering the size of the big problem of unemployment; but, like every other line of progress in modern life, the limits of unemployment insurance tend to recede by means of each little exercise of ingenuity by an individual, an industry, a state, or a nation, and by means of stimulating the inducements and ingenuity towards setting up collateral and auxiliary schemes of stabilizing the whole field of credit, taxation, government policy, business management and labor organization.

NOTES

1 Bureau of Economic Research, *Employment Hours and Earnings in Prosperity and Depression, U. S. 1920–22,* pp. 31–35, 54–59, New York, 1923.

2 Cf. *Illinois Labor Bulletin,* monthly issues, 1923, Chicago.

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MARX TODAY
Capitalism and socialism

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I

Karl Marx, the founder of materialistic socialism, is recognized by economists as one of the three or four greatest minds who have contributed to the progress of economic science. What he did was to take the theories of Ricardo, the founder of materialistic capitalism, and convert them from a political struggle between British landlords and capitalists, over the tariff and the rent of land, into a class struggle between all owners of property and all wage-earners, over the ownership of the whole product of industry. Ricardo had taken for granted the institution of private property, but Marx resolved property into exploitation of wage-earners through the power of the State, which, it was believed, created the rights of property.

Ricardo's theory did, in fact, leave the wage-earner in the position of a commodity or machine, from whose labor the capitalist derived his profits and interest. He looked upon the capitalists' profits as the moving force of industry, and upon high wages as the cause of low profits, and therefore the cause of stagnation of business and unemployment. Marx inverted this and made high profits (including interest and rent) the cause of low wages, and low wages the cause of stagnation and unemployment, because the laborers were not able to purchase back from the capitalists the products which the increasing efficiency of industry enabled them to create.

It must be remembered that Karl Marx wrote his Communist Manifesto at the end of the year 1847, following ten years of the lowest degradation reached by the working people of England and Europe since the time of the Napoleonic Wars. A prolonged depression of business, after the panic of 1837, with falling wages and unemployment, was just then about to precipitate the Revolution of 1848 in France and Germany, and similar but less violent distress in America. It was during these ten years that Marx revised the theories of Ricardo, and during the next twenty years he formulated his revision in monumental detail and published it in 1867.

There is much reason to conclude, had capitalism continued in the same direction after 1847 as it had during the thirty years after 1817, when Ricardo wrote his *Political*

Economy, that Marx's revision of Ricardo would have proven to be correct, for Marx described, in fact, what had actually been happening, and he predicted that it would continue to happen.

But there occurred, after 1850, and increasingly since that time, what may be named in part the self-recovery of capitalism, and in part its forced recovery, until today what may be named the stabilization of capitalism is apparently strengthening the system more than ever before.

The self-recovery of capitalism began with the general incorporation laws of the decade of the 1850s. Prior to that decade, in America and Europe, a corporate charter could be obtained only by a special act of the legislature. This procedure, in America, plunged the capitalists into political struggles in order to obtain corporate charters, with the resulting political corruption and anti-monopoly opposition. But, by means of general incorporation laws, the issue was taken out of politics, not by prohibiting corporations, as the anti-monopolists demanded, but by making them universal. Since that time the capitalists, in order to incorporate, do not go to the legislature for a special act—they merely file their articles with the Secretary of State.

This universal freedom to incorporate has counteracted the prediction of Karl Marx, not by making it false, as a whole, but by splitting it into two parts, the concentration of capital and the deconcentration of ownership.

Marx was the first to establish the inevitable concentration of capital in large units, at least in manufactures, transportation, and banking, through the effects of competition in wiping out the inefficient competitors and converting them into wage-earners employed by their former huge competitors. But he assumed that concentration of capital would be concentration of ownership, and this might have been the result without general incorporation laws. It would follow that ultimately only a few persons would own all the capital, while the masses of the people would become a proletariat of wage-earners and salary-earners, so that the inevitable revolution would occur by mere weight of numbers.

But the general incorporation laws have diffused the ownership of capital while promoting its concentration. And now, since great corporations have discovered how important this diffusion is for the augmentation of their capital itself, they are consciously spreading their stocks and bonds into the hands of thousands of investors, and are consciously stabilizing values where formerly the "insiders" employed the new device to exploit investors just as they exploited the laborers. Today the spread of investments, of insurance and savings, has interested millions of Americans in the preservation of capitalism.

But capitalism has needed legislation for this purpose and continues to need it. Corporate charters are, after all, acts of the legislature, giving to private individuals the sovereign privileges of unity, continuity, and limited liability. But, with these privileges, there are often corrupt insiders who rob investors and menace the stability of capitalism. It is largely by legislation, such as public-utility laws, blue-sky laws, watered-stock laws, and similar measures, that well-meaning capitalists can be protected in the main safeguard of capitalism, the confidence of millions of investors.

This is what I mean by self-recovery and forced recovery. Capitalists could not have recovered general support, since the time of the Communist Manifesto, without the aid of legislation, and legislation is, baldly speaking, nothing less than forced recovery coming to the aid of self-recovery.

Another application of forced recovery has come through labor legislation. In the very year, 1847, when Marx was writing his Communist Manifesto, the Parliament of England was enacting the first effective labor-law in the history of the world—the law limiting the work of women to ten hours per day. Labor legislation has now pushed forward in all capitalistic countries, supported by farsighted capitalists themselves, but opposed by the shortsighted. For competitive capitalism, in its grasp for profits and its fright of bankruptcy, pays no attention, on account of this very competition, to the health, leisure, or happiness of its employees, considered as human beings in contradistinction to profitable engines of production. When Bismarck was using all the power of the German Empire to suppress socialism and labor unions, he was, at the same time, introducing the most advanced legislation protecting labor against exploitation by capitalists; and, while this legislation has often been denounced as paternalistic, yet when it became evident that socialism and unionism could not be suppressed it was this very legislation that had its part in undermining the propaganda of Marxian socialism against the government of Germany and in furnishing to that country its healthy soldiers and patriotic armies.

II

Karl Marx, in 1847, could not predict this self-recovery and forced recovery of capitalism, either in England, in Germany, or in America, for he had no experience to go on. He knew only the cutthroat competition of individual capitalists, from the close of the Napoleonic Wars to the Revolution of 1848, and it was to that competition that he ascribed the increasing poverty of labor on which he based his forecast of revolution.

Another thing that Marx could not know about was the rise and progress of trade-unionism. It was not until the decade of the 1850s in England and America, and not until the decade of the 1880s in France and Germany, that trade-unionism began to take on its modern form of concerted aggression upon the profits of capitalists. Prior thereto labor had experimented with various forms of cooperation under the leadership of humanitarians like Robert Owen in England and America; or had joined in political parties designed to accomplish by legislation what they could not do individually; or had pressed for universal education, on which they based their hopes of improvement. But, beginning in the decade of the 1850s, they turned to limitation of apprenticeship, to the systematic organization of strikes and boycotts, to the restriction of output, to the establishment of shop rules protecting members against discharge and regulating transfers and promotions, limiting the hours of work and forcing wages above the competitive level.

Here it was that the more intelligent and aggressive element of the wage-earners was accomplishing immediately, within the capitalist system itself, the very appropriation of increasing profits which Marx predicted could come only through the destruction of capitalism. The outcome shows that the growth of trade-unionism, for sixty years following the Communist Manifesto, had a leading part in undermining the doctrines of the Manifesto among wage-earners. For when the Great War came it was the leaders of the trade-unions, men who had actually obtained short hours, high wages, and job

protection within the capitalist system, who rallied instinctively and without waiting to think about it, in all countries, to the support of their governments, on which capitalism depended for property and profits. In Germany, even, it was a collective bargain between Stinnes, the business agent of the capitalists, and Legien, the Gompers of Germany, that set up both the Republic of Germany and the recognition of unions in the shops. In America it was the trade-unionists, who knew by experience the destructive philosophy and tactics of communism, who joined almost unanimously in backing the government that was willing to recognize them as partners, along with capitalists, in this dreadful struggle of war. I know the strong feeling and the shrewdness of capitalists in preventing the spread of unionism, but the history of our capitalist civilization shows that these unions are really the firing line of the proletariat defending capitalism against that other proletariat which Karl Marx would call forth from the factories.

Trade-unionism is, as it were, another application of the forced recovery of capitalism from its anarchy at the time of the Communist Manifesto. And, in our own time, the foreseeing capitalists, who are opposed to unions of labor, are actually copying the shop rules which unions have established, wherever they could, for the protection of hours, wages, and jobs. This, in a way, is again the self-recovery of capitalism.

A serious oversight of Marx was that of the incompetency of labor, as a class, in managing business. It might truthfully be said that the work of one man like Ford, Carnegie, Rockefeller, or Harriman, is equal to the work of all his 50,000 or more employees put together. What he does is to change them from a mob into a going concern. The way in which these great organizers of labor have come forward, under the capitalist system, is the method which Darwin has taught us to name natural selection, distinguished from artificial selection. Artificial selection of leaders in industry, politics, or war, is the popular election by subordinates of their own commanders. But natural selection, in industry, is the self-election of commanders by survival in the competitive struggle for profits. They are elected by their own success, not by the votes of those whom they organize and command. This is the substance of capitalism as against socialism: the foremen, superintendents, executives, boards of directors, are not elected by the wage-earners who must obey their orders—they are selected from above by those whose sole consideration is the profits that they can deliver. Hence these commanders are not responsible to the wage-earners they command. They are responsible to the capitalists.

In every case that I know of, and in every country, where workingmen have formed the so-called producers' cooperatives, in order to become, as they say, their own employers, and have thus elected their own foremen, superintendents, and directors, they have failed. Laborers, as a class, are incompetent to elect the boss. Individual laborers may rise out of the class, and even rise to be millionaires, but that is capitalism. Socialism requires that laborers shall rise as a class by becoming their own boss as a class. This is incompetency. Labor, as a class, is composed of conflicting religions, conflicting races, colors, sexes, ages, unequal abilities and intelligence, and all of these conflicts and inequalities show themselves in the competition for jobs and wages. When, therefore, they elect the boss, it is not on the ground of his efficiency and discipline, but on account of his sympathy.

The trade unions have learned this cold fact, that they cannot manage business as a union or as a class. The unions know that they can get high wages, short hours, and job

security only because it is the capitalists who take the first risk and who therefore must do the planning and managing. The leaders of the socialists are usually so-called "intellectuals" and professional people, who flatter or idealize the laborers, but the unionists are laborers themselves and they know by experience that they can get more out of capitalism by bargaining with it collectively than they can be taking it over and managing it collectively.

It is charged by socialists that profit-making is pure selfishness, the inference being that, if wage-earners were in control, public service and not self-aggrandizement would be the standard of business. It is difficult to see, however, any difference, in this respect, between profit-making and wage-earning. Both are the process of pure self-interest endeavoring to get as much as possible for self with as little as possible for others. From the public standpoint the real question is, how can this universal selfishness of mankind be so organized that, in pursuing his own self-interest, everyone may incidentally, and without intending to do so, actually promote the common interest? Not much reliance can be placed upon protestations of serving the public. As Adam Smith, the great advocate of private property as the motive force of industry, has himself said in his *Wealth of Nations:* "I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it."

This, I take it, is the source of the strength of capitalism and the source of its efficiency. It is from the institution of private property that this strength is derived. Private property compels efficiency by the penalty of bankruptcy.

Yet the capitalists themselves do not always distinguish between productivity and efficiency. Productivity may seem to be increased by lengthening the hours of labor, or bringing in cheap immigrant labor, or substituting women and children for men. But efficiency consists in reducing the hours and getting a larger output per man-hour. Productivity seems to the capitalist to be measured by success in acquiring wealth. But efficiency is measured by success in producing wealth. Karl Marx was the first to make this distinction clear. It is private property that permits the confusion to exist, for private property is mere selfishness, and it is only because capitalism has devised, or has been forced to submit to, rules of the game laid down in the common interest that it is arriving at the distinction between getting rich by efficiency and getting rich by exploiting the laborers and consumers.

These rules of the game have a certain effect, if they are properly devised: they arouse in the mind of the capitalist that sense of responsibility in the pursuit of private gain which is coming to be known as business ethics.

There is no single source from which this so-called business ethics is derived. The most general source sometimes referred to is public opinion. But public opinion is ineffective unless backed by some kind of organization with power to inflict some kind of penalty that will be felt by him who otherwise is unmoved by this sense of business ethics. I take it that the amazing increase in numbers, in recent times, of trade associations, whether of business men or of farmers or of laboring men, is a promising source of these sanctions of public opinion.

III

Here is the culminating oversight of Karl Marx in his theory of socialism, and the one which comprehends all the others: namely, the failure to see the importance of custom, and what, in Anglo-American jurisprudence, is named the common law. The same oversight existed for Ricardo, for Adam Smith, and for the capitalistic as well as socialistic economists. For them there was no intervening principle of human behaviour between the compulsory edicts and laws of sovereignty, on the one hand, and the individual bargains of private property, on the other hand. Private property, for them, was actually created by the sovereign, and it logically followed that the sovereign could abolish private property.

But if we recognize that private property—or rather the rights, duties, liberties, and liabilities of private property—is merely an historic custom of private property, superior even to the State itself, and not only quite recent in the history of the race, but also continually changing as economic conditions change, then we can see that between the individual and the State is a supreme principle of stabilization by custom which both regulates the individual proprietor, on the one hand, and overrides the arbitrary will of the State, on the other hand.

The term "property" is sometimes distinguished as the object which is owned, and is thus set over against the phrase, "rights of property." From the economic standpoint, however, we should say that the term "property" signifies the purely selfish interest of a person in the exclusive control by himself of any object, or even of any other person, whose supply, in general, is limited. Wherever there is unlimited supply which is expected to continue unlimited, there is no need of property. Property is, indeed, the scarcity aspect of commodities, and is just as applicable to slavery, based on the scarcity of labor, as it is to commodities based on the scarcity of food, clothing, and shelter. We may even call property the instinct of scarcity, and make it identical with what we might call the instinct of property, in order to distinguish it from that other phrase, the rights of property, based on custom.

The rights of property signify the rights, duties, liberties, liabilities, immunities, privileges, and so on, which, for the time being, the custom of his associates, or his community, or his nation, may be expected to apply to the individual in the promotion, liberation, or restraint of his instinct of property.

This is what is really accomplished by the trade associations and their standards of so-called business ethics. These associations are the rise of a new custom which tells the individual capitalist what he can, cannot, may, must, or must not do, in obtaining possession of things that are scarce. All customs, from the beginning of the human race, have originated in this way, and business ethics is but repeating for capitalism what custom has always done, from the time of primitive communism to that of capitalistic civilization, in regulating this instinct of property, which is the instinct of scarcity.

It is out of these customs that the common law arises. But we do not reach the need of a common law until disputes arise which must be decided promptly in order to keep the association, or community, or nation, in a peaceable frame of cooperation. In this sense, there is a common law that arises in all private associations without any intervention of the State, as when a board of arbitration is set up by the parties interested, or when

factory rules are enforced by superintendents and general managers, or church rules enforced by ecclesiastical authorities. The peculiar common law of the State comes in only when a decision is made by a court which directs the use of the collective physical violence of the community. The capitalistic associations have their own common law, enforced by profit, loss, jobs, unemployment, bankruptcy, loss of patronage, and so on.

In all of these instances the common law authority, whether of the association, the community, or the nation, must decide between the practices of individuals or associations in their dealings with each other, as to which practices are good and which practices are bad, so that the common law of any institution has grown up by the artificial selection and approval of what are deemed good customs, and the rejection and disapproval of what are deemed bad customs. In the course of time these approved customs become so fully accepted and are deemed so obvious and commonplace that they acquire the name of "natural rights" or even "divine" and "sacred" rights, as they were called by Adam Smith and Blackstone, 150 years ago. Yet they are but the gradual evolution of approved practices through artificial selection by the courts, employed as standards in order to decide disputes in a world of limited opportunities.

It is for this reason that approved customs are so powerful both respecting the individual and respecting any effort of the State to change them. They do change gradually, but even these changes are also so powerful that neither can the State refuse to change its statutory law, nor can the judiciary persistently refuse to change its common law, to fit the changing customs.

It is this changing fact of custom and common law which has always set up the principle of stabilization. The common law established in early times, for example, the principles of the market overt, with its publicity, free access, and negotiability of commodities, so that men could know what to expect. The good customs of the market became the common law. The same is true today under the amazing changes brought about by a world market and the competition of business on narrow margins. Always the common law attempts to stabilize good practices by excluding the competition of bad.

This early stabilization of the market overt was followed, during the seventeenth and eighteenth centuries, by the stabilization of what has now become the most important of all business assets, the goodwill of a going business, and this turns out to be perhaps the greatest of all regulators of business in the public interest. For it sets up, as an inducement to the capitalist, the longtime future advantages of fair competition in place of the short-time cutthroat competition that Karl Marx knew about. Marx, indeed, knew nothing of the goodwill of a business, or of the way in which the judiciary, for 300 years, has been constructing it out of what are deemed to be the good practices of business. Goodwill was not, in fact, a big factor in business until the corporation, instead of the individual or partnership, became the owner of goodwill.

This goodwill idea has been extending, in recent times, to wage-earners as well as customers and investors, and capitalism is learning that its own efficiency turns on maintaining the goodwill of the increasingly independent, free, and organized laborers, as against the old customs out of which the law of master and servant was constructed. Karl Marx could scarcely have imagined such an outcome of capitalism as he knew it about 1847.

One thing to be noted about the evolution of good customs is that they do not advance equally with all capitalists, and this is the reason why courts, legislatures, and

commissions are found necessary to assist the more progressive in bringing up the laggards. Karl Marx had before him the destructive effects of the ethically worst competitors in compelling their better competitors to come down to their level. He did not perceive that the State, either as legislature, executive, or judicial interpreter of the common law, might increasingly protect the good practices of capitalism and restrain the bad practices. It has required and is requiring the State, either in its legislative, judicial, or administrative capacity, to perform this service, but in no case can either branch of government go very far ahead of what is customary and sanctioned by associations, though it may fail to go as far as better customs would already support.

IV

This process of stabilization of capitalism through custom has been passing through two stages, a stage of conspiracy and a stage of regulation. The conspiracy stage reached its climax in the Sherman anti-trust law of 1890, and the regulation stage can hardly be said to have had a beginning prior to the twentieth century.

It was in the year 1898 that the coal-mine workers and coal operators, in the bituminous fields which marketed their products toward the Great Lakes, framed their collective agreement based on the principle of equalizing competitive conditions. They established, for the entire area, a complicated set of rules, fixing minimum wages, maximum hours, and mining conditions, so designed that every coal operator, no matter what the differences in the richness of the mines, could get into the market at practically the same cost, including wages, transportation, and mining-conditions. Prior to that time cutthroat competition had reduced profits and wages below the subsistence level for both capital and labor, but since that time a live-and-let-live policy has considerably stabilized competition, though many amendments have been required from year to year and are still required. Here is a notable example of self-recovery and forced recovery in a great industry, extending over four states and superseding, to a considerable extent, both the conflicting laws of the state legislatures and the commands of the judiciary.

In another field, that of railway transportation, the period of conspiracy did not come to an end until the Federal Congress enacted the law of 1906 which, for the first time, succeeded in fixing, by a commission, the actual rates, and permitting little or no deviation.

In the field of manufactures the new policy of stabilization may be said to have started with the Steel Corporation about 1908, when it ceased the old Carnegie policy of killing off competitors, and adopted the new live-and-let-live policy. This new policy did not finally get judicial sanction until the dissolution suit of the Attorney-General against the Steel Corporation, decided in 1919. Here it was judicially found that although the practices of the Steel Corporation, along with those of its competitors, were plainly concerted movements similar in their effect on prices to those which formerly had been held to be restraints of trade, yet these concerted movements, in their new form, were to be approved because they showed that the Steel Corporation had not resorted to the destructive practices and price-wars that eliminated competition. The court declared that

the Steel Corporation had not reduced wages, had not lowered the quality of its product, had not created artificial scarcity, had not coerced or oppressed competitors, had not undersold competitors in one locality and maintained prices in other localities, had not obtained customers by secret rebates or departures from published prices. Neither competitors nor customers, said the court, testified to any oppression or coercion on the part of the company, and they testified to a general satisfaction with the well-known and published policy of stabilization of prices and deliveries pursued by the Corporation.

It is plain, therefore, that the policy of stabilization through publicity, for labor, for transportation, for manufactures, has, within the past few years, become the policy, not only of capitalism itself, but also of unionism, of statute law, and of the common law as interpreted by the Supreme Court.

The most fundamental stabilization has been that of credit and prices through the cooperation of the banks organized in the Federal Reserve System. This policy can hardly be said to have been agreed upon before the year 1923, when the Federal Reserve Board, on the advice of the leading bankers, laid down the rule, in effect, that the operations of the banking system should no longer be left to the accidents of demand and supply of gold, but should be directed toward stability of credit, which means stability of the general price-level. The country had become prepared for this stabilization of business, credit, and prices, owing to experience with the effects of war inflation and post-war inflation and deflation. The stabilization was brought about by a system which, for the first time, permitted and authorized the bankers of the country to unite through their representatives, but under the supervision of a board representing the people, and to draw up their rules governing discounts and rediscounts, purchase and sale of securities, and other matters affecting credit directly, and indirectly affecting the volume of business and the general level of prices. For the past two years this stabilization has been surprisingly effective, preventing general inflation in spite of the surplus of gold, and, while there may be need of improvements in procedure or in representation of interests other than those of the bankers, which experience will reveal, yet no greater service toward the self-recovery of capitalism can be suggested than this stabilization of credit, business, and prices for America and the world.

V

We may infer from these specific cases something about the ultimate philosophy on which Karl Marx based his theory of socialism, in contrast to the actual historic process of stabilization through custom and law. Marx took his philosophy from Hegel, who had developed his famous theory of social evolution through the dialectic process of thesis, antithesis, and synthesis. This evidently is the process by which the human mind rises from the observation of a fact to the negation of that fact, and then makes a higher generalization, or synthesis, which includes both the positive and negative observations. In this way Hegel pictured the evolution of what he called the Idea, in the history of mankind, this idea starting with the thesis of primitive communism, then going over to its exact opposite, the extreme individualism of the French Revolution, then culminating in

what he hoped would be the synthesis, a great German Empire that should afford the advantages of both the sovereignty of the State and the liberty of the individual.

But Marx inverted this process by changing the Great Idea into tools, machinery, commodities, and social labor-power. It was, for him, the invention and evolution of methods of production of wealth that caused all changes to occur in religion, ethics, property, and the State. The thesis now remained primitive communism, as before, but the antithesis became individualistic capitalism, and the synthesis became, not the German Empire, but a new communism extending over the world.

The outstanding characteristic of both Hegel's and Marx's philosophy was the idea of an impelling force that worked out its evolution regardless of the will of man. The individual was helpless to push it on or hold it back. Consequently, in both cases, the actual historical evolution of collective wills was overlooked. The collective will was identified with sovereignty, or communism, whereas the collective will is really custom. And in Anglo-American history we find this collective will moving forward as the common law, including under this designation the law-merchant, or the custom of capitalists, as well as the law-agriculture, or the custom of feudal landlords and farmers, and the law-labor, or the custom of labor and trade-unions.

There is, however, a certain parallel between the dialectic of Hegel and Marx and the actual development of the common law. This parallelism may be distinguished as an early period of scarcity preceding the invention and use of the steam engine; then a period of abundance and even oversupply during the nineteenth century; and the period of stabilization, beginning with the twentieth century.

It was during this early period of scarcity that the common law developed its principles of the market overt, while the guilds of manufacturers and merchants were developing, in their own courts, their own rules respecting manufacturing, merchandising, and credit.

The period of abundance, which followed machinery and the steam engine, was the period of individualism and the abolition of many of the restrictions of mercantilism, of guilds, and of ancient customs. This period of abundance naturally became, at the hands of Adam Smith in 1776, the foundation of his doctrine of unregulated private property. According to this doctrine the instinct of property alone, without the aid of legislation or custom, was sufficient to augment the wealth of nations, while, at the same time, owing to this very abundance of wealth, the instinct of property could not injure anybody. But the nineteenth century, with its alternations of prosperity and depression, its overemployment and unemployment, its unregulated and cutthroat competition, showed the mistakes of this doctrine, and hence, at the close of this century, the period of stabilization began to take shape.

But this stabilization has not been an inevitable evolution of either Hegel's Idealism or Marx's Materialism—it has been the conscious activity of the collective wills of business men, of workingmen, of farmers, of the judiciary, of legislatures, and of public boards and commissions, endeavoring to adapt their customs, their rules and regulations, to the new industrial conditions by eliminating such practices as secrecy, extortion, discrimination, instability, and substituting such practices as publicity, security, and what in general may be known as the common-law concepts of reasonable value and reasonable practice. All of this is the conscious efforts of collective wills in thousands and millions of associated efforts, and the process is moving in a different direction from

that prognosticated by Hegel or Marx. It is being developed through the age-old practices of custom. We can see these new customs getting themselves into the new common law, and it is not socialism toward which Western civilization is advancing—it is the stabilization of capitalism through custom and law.

Doubtless the most offensive of the theories of Karl Marx was his theory of class struggle between owners of property and non-owners, to be ended by a world-wide revolution, followed by a temporary dictatorship of the proletariat, and then a final harmony of all interests without dictatorship, after everyone has accepted the principles of communism.

The older economists, led by Adam Smith in 1776, had, in large part, accepted a principle of harmony of interests, provided that neither the State nor any guilds or other private associations should interfere with the natural workings of private property under the motive of pure self-interest. This alleged harmony of interests was plausible enough under the circumstances of the enormous increase of efficiency following the expansion of markets, the invention of machinery, and the application of science to industry, under the inducements of private property. It seemed to follow, since in an age of abundance the opportunities would be unlimited, that nobody could injure anybody else in his selfish pursuit of wealth, because everyone would have unlimited alternatives to which he could freely turn if not satisfied with the treatment he was receiving.

Karl Marx accepted that part of this theory which asserted the enormous increase in productivity of the capitalist system, and, indeed, he made it an essential part of his own philosophy. What he added was done merely by pointing out that this very increase in efficiency created a propertyless class of wage-earners, employed by the capitalists, whose lack of property prevented them from sharing in the increased efficiency of capitalism.

Thus Marx, like the economists, set up the idealism of a future harmony of interests, the one to come by perfectly free competition, the other by perfectly supreme communism.

But this entire idealism of harmony of interests, whether under capitalism or under socialism, falls to the ground if once we recognize that social conflict has always been and always will be a fundamental fact in the progress of mankind. It follows from the mere fact of increasing population and increasing wants and necessities, which, no matter how great the increase in efficiency, are continually pressing upon the natural resources of the world. It is not so much the food supply that is the limiting factor, at least in our Western capitalistic civilization, as Malthus and Ricardo predicted, as it is the coal, iron, oil, water power, and the limited landsites available for the congestion of population, all of which are required in order to accomplish this increase in efficiency. There has not been and never will be an automatic harmony of interests, because there always will be scarcity of essential resources and of privileged areas of land through increasing pressure of population. If harmony of interests is actually attained, it can be accomplished only as we go along, from day to day, dealing with each conflict as it arises, and settling it the best we know how.

This is what is meant by the concepts of reasonable value and reasonable practice which guide the courts in deciding disputes. These are economic concepts growing out of a free, equal, and public balancing of conflicting economic forces in a world of scarcity, and depending upon a thorough investigation of all the contending interests.

The concepts of reasonable value and reasonable practice are acquiring new and larger meanings than ever before, owing to this new stabilization of capitalism which may involve secrecy, discrimination, and extortion. Their significance arises from the need of deciding economic conflicts as we go along, without waiting for ultimate ideals. But instead of a two-sided class conflict, as Marx predicted, we have actually millions of individual conflicts and thousands of class conflicts at every point where scarcity of resources places its limits of opportunity upon the individual, or class, or even the nations of the world. There is abundance in some directions, scarcity in other directions.

These conflicts over scarcity ultimately press upon the judiciary and the legislatures for decision. Yet these two branches of government have shown themselves often incompetent to decide class conflicts. The legislature does not accurately represent the parties to the dispute. It is the lobbies that are more truly representative of classes than the legislatures. The judiciary, on the other hand, while it is suited to decide individual conflicts where the rules of the game have previously been laid down, yet is unsuited to decide the conflicts of classes themselves where the rules themselves are developed.

This incompetency of legislatures and judiciary has led the people of various states and the nation to install a set of commissions designed to deal with the more urgent of these class conflicts. The Tax Commission deals with the conflict between taxpayers as to how the burden of taxes shall be shifted between farmers, business men, and laboring men. The Railroad Commission deals with the conflict between public utilities and the shippers of goods or the consumers of light, heat, water, and power. The Industrial Commission deals with the conflict between employers and employees. The Market Commission deals with the conflicts between buyers and sellers. These commissions differ from courts in that they deal primarily with classes, while courts deal primarily with individuals.

All of these commissions are not a recognition of Karl Marx's two-sided class struggle between owners and non-owners, and certainly they are not an acquiescence in the older theory of harmony of interests. They are a recognition of the hard fact that conflict of classes is with us continuously, but that this conflict is as many-sided as there are classifications of the people according to their economic interests. It is not really a struggle between classes, as understood by Marx. It is a struggle between classifications—for no individual is tied up to a single class, as Marx contended, and as might be true in Europe, but every individual belongs to as many classifications as he may have conflicting economic interests.

In American states, if there is anything like an economic class-struggle, it is a three-cornered and not a two-sided struggle, for there seems to be a line-up separately of capitalists, farmers, and wage-earners, each rather highly organized, and each not only shifting its alliances back and forth with the others, but each continually shifting within its own membership. It is doubtful whether either our legislatures, our commissions, our judiciary, our politicians, our lawyers, or our professional men, can successfully deal with such an economic conflict. And it is evident that these several interests are already taking the matter in their own hands, dealing jointly and directly with each other through their own representatives, sometimes under the supervision of governmental bodies. The single rule of the game, that they should lay their cards on the table instead of playing a secrecy game, might lead to some agreement respecting the facts, at least, if not the policies, which then could be accepted by legislatures, commissions, and judiciary.

At any rate, when once it is recognized that there is no such thing as an automatic harmony of economic interests, either under capitalism or future socialism, and that economic conflicts are not merely conflicts between individuals, which can be decided in court after the damage is done or is imminent, but are conflicts between classifications of individuals, which might be adjusted before a break occurs, then some progress can be made toward approaching, not an ultimate ideal of harmony, but merely that series of next steps which will keep the concern improving from day to day—the Reasonable Stabilization of Capitalism.

31
PRICE STABILIZATION AND THE FEDERAL RESERVE SYSTEM

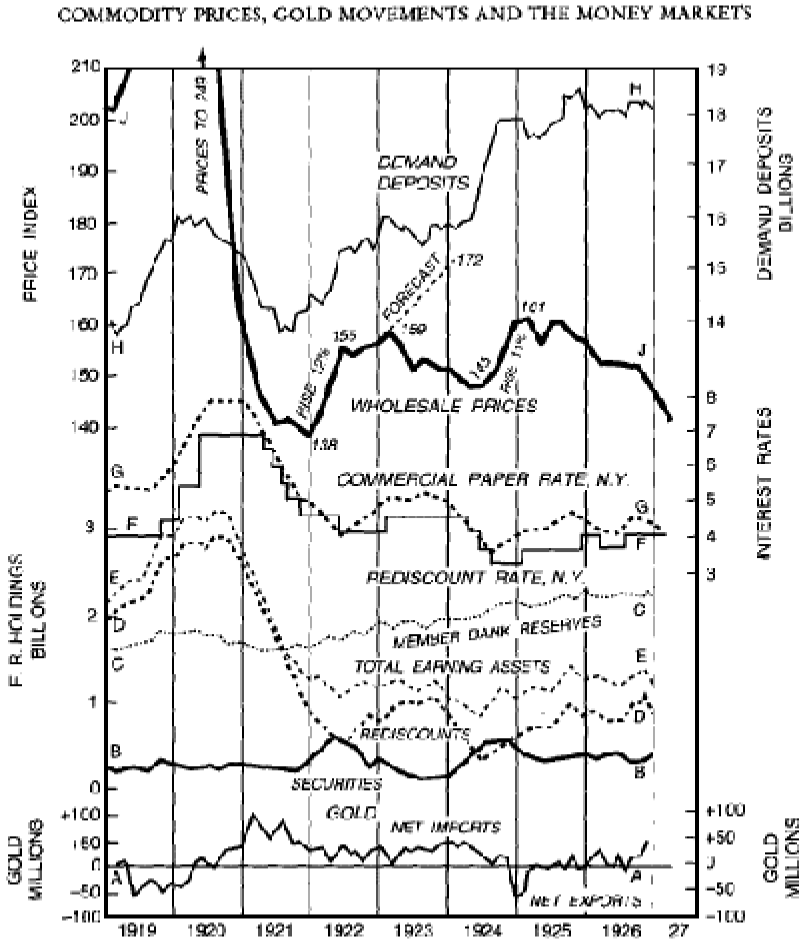
The Annalist 29 (April 1, 1927):459–462.

In the summer of 1919, at the peak of credit inflation, I found that "offpressers" in the clothing industry of New York were being paid $125 per week when the union scale was $50; and after the union prohibited its members from accepting more than $50 the employers hid their employees when the union committee came around to discover and penalize them. Again, in the same year, truck-drivers in Cleveland abandoned their trucks on the streets if an accident occurred and got another job with another employer. They had lost the sense of responsibility for their job. Within a year and a half, at the trough of credit deflation, these same laborers, and 4 million others, were out of work. Credit inflation demoralized labor and then deflation pauperized it.

In February, 1923, I attended a luncheon with some twenty of the most famous business forecasters. Someone proposed that each should make his guess as to what would be and when would occur the expected peak of wholesale prices. The average of their forecasts was a peak of 172 to occur in February, 1924. Prices had been rising during 1922 at a rate more rapid than during the inflation of 1919. They had gone from 138, on a "pre-war basis" of 100, to 156 when these forecasters made their guesses. A look at the accompanying chart will show that, instead of continuing to rise, prices started to fall within two months after these forecasts were made, and that in February, 1924, the level stood at 154 instead of the expected 172. Later it plunged down to 145 in June, 1924. The forecasters failed so badly because they did not know what the Federal Reserve System was doing or going to do.

RESERVE BANKS CAN CONTROL PRICE LEVEL

When the Federal Reserve act was in process of enactment the bill laid down two policies for guidance of the system. It was instructed to use its powers to "accommodate business and commerce" and to "stabilize the price level."



But in the conferences between the two houses the latter clause was eliminated, and only the direction to "accommodate business and commerce" was retained. This is equivalent to no direction at all. Suppose stability of the wholesale price level had been retained as

the aim. Would we then have had in so large a degree the inflation and deflation of 1919 and 1920 or the minor inflations and deflations of 1922–1923 and 1924–1927?

A legislative rule directing the Reserve System to stabilize the general level of wholesale prices calls for no additional powers to be granted to the System—it already has all the power needed and its leaders have the ability needed. The lack only a rule of stabilization.

I do not say that the System has fully recognized its own power in the past. I date the beginning of this insight, on the part of its more astute leaders, from about May, 1922, to April, 1923. They learned their power by experiment. In the latter part of 1921 the twelve Reserve Banks, each acting on its own initiative, began buying Government securities (Curve *B*), and by May, 1922, had some $400 million of such securities. They did this solely in order to acquire investments on which to earn a profit, because the member banks had reduced their borrowings and their rediscounts (Curve *D*), so that very little of earning assets remained.

Yet, strangely enough, these purchases of Government securities seemed actually to reduce the earning assets of the Reserve Banks (Curve *E*), instead of increasing them as had been expected, because the member banks continued to reduce their borrowings and rediscounts by more than the increase in Government securities (Curves *D* and *B*). This seemed very strange, and I have the authority of bankers close to the situation that they did not know what was happening. The System, however, soon learned what was happening, and it has based its control of credit on that knowledge since the beginning of 1923.

LESSONS OF 1922–1923

What happened grows out of a “working rule” authorized by Congress, and a corresponding custom gradually adopted by the member banks. The rule and the custom both arise from the fact that the gold reserves of the member banks were turned over to the twelve reserve banks and pooled by them, so that the legal reserves of member banks are no longer gold or other “lawful money” in their own vaults or in other private banks. Their legal reserves now are solely reserve credits at the Federal Reserve banks. In other words, here is a common fund of gold and a common fund of reserve credit whose supply is limited, and the “working rule” and custom provides that no bank shall continuously borrow, except in emergencies, more than its proper share of this limited common fund in order to relend it at a profit to business customers.

It can be seen, by reference to the chart, what enormous profits member banks could theoretically make if they created credit reserves by rediscounting at the Reserve banks and then extended their loans to business customers up to the limit set by the legal minimum of demand deposits relative to legal reserves. Every dollar of legal credit reserve owed by a Reserve Bank to a member bank enables the system as a whole to lend to the business public as much as will create eight or nine dollars of demand deposits. In other words, the demand deposits (Curve *H*) (which serve as “money” in the form of deposits payable on demand), are eight or nine times the total member banks’ reserves

(Curve *C*). The apparent profit obtainable is enormous. By thus borrowing, say $1 million at the Reserve banks at, say, 4 percent, the banks of the system as a whole could, unless prevented by this "working rule" and custom, lend to the business public $8 million or $9 million at 5 percent or 6 percent.

This was, indeed, the argument held out, in the early years of the system, by certain of the Reserve banks to the State banks to induce them to become members of the system—the profits they could make by borrowing and relending.

LIMITATIONS ON MEMBER BANK BORROWING

But the "working rule" and the custom referred to, have prevented the member banks from taking advantage of this source of unearned profit; and properly so, for the result of a general disregard of this "working rule" under present conditions would mean inflation.

The "working rule" is authorized by Section 4 of the Federal Reserve act, which permits the Reserve banks to limit the accommodations to any member bank with "due regard for the claims and demands of other member banks." Under this rule a member bank continuously in debt to a Reserve bank may be scrutinized and warned that it must keep its borrowings and rediscounts down to an emergency basis unless it can be shown that, as lately in agricultural districts, its loans are more or less frozen and it needs continuously the help of the system.

This applies to what may be named "marginal banks," or weak banks. On the other hand, the strong banks keep out of debt, not permitting their published statements to show indebtedness to the Reserve Bank, simply on account of a custom which is even more powerful with them than the working rule enforced upon the weaker banks. Their reputation, their good standing, their honor as a strong bank, keep them from borrowing at the Reserve bank in order to relend at a profit, and almost no more insulting question can be asked of one of them than the question, "Do you borrow at the Reserve bank in order to relend at a profit?"

In this respect the member banks act like a trade union. The members of the union know that there is a limited number of jobs and a limited amount of work offered on the labor market. It is, therefore, unethical for a member to take more than his share by cutting wages or working too fast, or working more hours than his fellow-members. A similar custom has arisen among business men in many industries during the past twenty years. It is unethical to steal a competitor's customers or laborers by cutting prices or raising wages. They may get what they can from each other by arts of salesmanship and good management, but not by price-cutting or wage raising. The Federal Reserve System is like these unions. It is not a monopoly—it is a trade union of 10,000 member bankers, each acting on his own initiative, yet all acting alike by a system of collective bargaining in their transactions with millions of business customers, each bank having "due regard for the claims and demands of other member banks."

LENDING TO THE LIMIT OF RESERVES

There is another custom, just the opposite of this, which has grown up with the Federal Reserve System—the custom of lending up to the legal limit of the member bank's reserve credit at the Reserve Bank.

Prior to the Federal Reserve System each bank had to keep its legal reserve in lawful money in its own vaults or in a credit at a Reserve City bank. But, under the Reserve System, money in its own vaults and credits with other private banks do not count as legal reserves. Only its credit balance at the Reserve Bank is its legal reserve.

Now this credit balance is highly elastic. It can be increased, in case of emergency, simply by borrowing at the Reserve Bank, or by discounting eligible paper owed by the business public to the member bank, or by selling Government securities. Consequently, whereas before the Federal Reserve System each bank endeavored to keep its reserve above the legal minimum in order to be ready for emergencies, all of them now extend their demand deposits continuously up to the legal maximum, which is the same as the legal minimum reserve. The legal maximum of demand deposits is based on the legal minimum of credit reserves. And this maximum and minimum ratio keeps very close to the ratio of eight or nine demand deposits to one member bank reserve (Curves *H* and *C*).

It is this two-sided custom of member banks—lending up to the maximum, but keeping out of debt as much as possible to the Reserve banks—that seems to account for the quick response throughout all parts of the country, to open-market sales and purchases of securities and to changes in rediscount rates by the Federal Reserve banks.

EFFECTS OF SECURITIES PURCHASES OF 1921–1922

This response in all parts of the country at the same time, however, was not discovered until about May, 1922, and was not clearly acted upon until April, 1923.

The twelve Reserve banks, each on its own initiative, as already stated, purchased $400 million securities from the latter part of 1921 to May, 1922 (Curve *B*), with no other intention than that of increasing their earning assets. But the latter were actually reduced from $1,300 million (October, 1921), to $900 million in July, 1922 (Curve *E*). The explanation is simple and is now well understood. If a Reserve Bank purchases $1 million of securities from a broker in the open market, it does so by a check drawn against itself, and the broker deposits that check with a member bank which immediately deposits it with a Reserve Bank, thereby increasing nominally the member bank's credit reserve $1 million.

The member banks, however, do not increase their loans to the business public eight times as much as this increase in their credit reserves—they proceed first to reduce their

indebtedness to the Reserve banks (Curve *D*); and the member banks' reserves, therefore, instead of increasing $400 million in 1921–1922, were increased only $200 million during the year 1922 (Curve *C*). It was this increase of their credit reserves that enabled the member banks to increase their demand deposits about nine times the increase in credit reserves (Curves *H* and *C*). The response was immediate. The total demand deposits, which is the total supply of credit money payable on checks drawn by the business public, increased $1,800 million in the fifteen months to November, 1922 (Curve *H*).

The corresponding effect on the 60–90 day commercial rate in New York was also immediate. The rate fell from $5\frac{1}{4}$ percent in November, 1921, to 4 percent in June, 1922 (Curve *G*), a decline of 21 percent in the rate of interest on short-time loans to the business public. Along with this the rediscount rate at the New York Reserve Bank was reduced from 5 percent to 4 percent, keeping mostly below the commercial rate.

This contradicts a widespread illusion respecting the power of the Federal Reserve System to control its rediscount rate. It is held that the System cannot control the market rate—it can only follow the market rate. What happens, however, is that the reserve banks first prepare the market and then follow what they have prepared. They prepared the market in 1922 by open market purchases of securities. They followed the market by reducing the rediscount rate. By observing the curves on the chart (*B, G* and *F*) the reader will notice that this has repeatedly been the sequence. The purchases of the securities *(B)* lowers the commercial rate *(G)* and the rediscount rate *(F)* follows. Likewise the sale of securities *(B)* raises the commercial rate *(G)* and this is followed by a raise of the rediscount rate *(F).*

WHOLESALE PRICE LEVEL RAISED

Lastly, the effect was shown, in 1922, in the rise of wholesale prices of commodities. These rose within the six months, January, 1922, to July, 1922, from 138 to 155 (Curve *J*), an increase of 12 percent in six months, which was a more rapid rate of increase than the increase during the inflation of 1919.

Even yet, in 1922, the Reserve bankers had no idea of what they were doing by their purchase of $400 million securities. Their only idea was that of any private business, that they should make use of their gold reserves to increase their earning assets and profits. It required considerable time for them to learn that they were actually reducing their earning assets instead of increasing them (Curve *E*); that they were reducing commercial rates (Curve *G*); that they were inflating the total volume of credit money (Curve *H*); and that they were inflating prices (Curve *J*).

SECURITIES DEALINGS CENTRALIZED

The first complaint came from the Treasury Department. The purchase of Government securities had interfered with the prices of those securities in the market, and the Treasury asked for a system of orderly marketing that would not disturb the Government financing. So the Reserve banks created a central committee to act as agent of the twelve banks in the purchase and sale of securities. For the first time the twelve Reserve banks now began to act as a unit.

This committee began selling securities (Curve *B,* 1922), and then, in the beginning of 1923, the committee was reorganized as the Open Market Investments Committee, taking all initiative away from the twelve Reserve banks in the matter of purchase and sales of securities. By this time the leaders had learned that they could stop inflation, and even produce deflation, by selling securities, just as, without knowing it, they had produced inflation by buying securities in the first half of 1922.

Then, in April, 1923, the Federal Reserve Board confirmed this new experience by adopting a general order that the purchase and sale of securities should be guided by their "effect on the general credit situation," a rule that added something, but was still as vague as the legislative rule of "accommodating commerce and business."

It was this two-sided custom that I have mentioned above and this "working rule," then in process of formulation, which the twenty forecasters did not know about in February, 1923. They guessed 172 as the peak of prices to arrive in February, 1924, whereas the Reserve System was even then stopping the further inflation, and the peak came at 159 just two months after, instead of 172, twelve months after the time when their forecasts were made. And when their expected peak, 172, was due to arrive the Reserve System had brought the price level down to 152—twenty points below the expected peak—approaching rapidly a trough 145—twenty-seven points below their expected peak (Curve *J*).

These movements can be seen from the chart. The open market sales of securities totaled $400 million from June, 1922, to July, 1923. The holdings of Reserve banks were reduced to only $90 million (Curve *B*). Forthwith the member banks were forced to restore their impaired reserves by borrowing about $180 million from the Reserve banks (Curve *D*), and the feat was all the more remarkable because the member banks were receiving, during the year 1923, net gold imports of $295 million (Curve *A*), which they used to reduce their indebtedness or augment their reserves at the Reserve banks. The open market sales more than counteracted the gold imports.

DEFLATION OF 1924 OVERDONE

In the beginning of 1924 the leaders of the Reserve System discovered that they had overdone the deflation. As stated by Governor Strong of the New York Federal Reserve Bank, before the House Committee on Banking and Currency in April, 1926, the falling prices in agriculture, the extensive failures of agricultural banks and the menace of radical legislation induced the system to reverse its policy. The changes can be seen in the chart. The System purchased a total of $470 million of securities from November, 1923, to October, 1924 (Curve *B*), which added to the net imports of gold, $295 million (Curve *A*), enabled the member banks to reduce their borrowings $800 million, from the high point $1,100 million in December, 1923, to the low point $300 million in August, 1924 (Curve *D*), and to increase their credit reserves $200 million during 1924 (Curve *C*).

The effect was almost immediately seen in the reduction of commercial rates at New York from 5 percent in the Fall of 1923 to $3\frac{1}{8}$ percent in September, 1924, the lowest since 1916, being a reduction of 39 percent in the commercial rate of interest (Curve *G*). This was followed by reductions in the New York rediscount rate from the high point $4\frac{1}{2}$ percent to the lowest point, 3 percent (Curve *F*), during the history of the Federal Reserve System. Correspondingly, the increase of $200 million in member bank reserves (Curve *C*) enable the member banks to increase their demand deposits $1,700 million (Curve *H*), about eight times the increase in member banks' reserves (Curve *C*), and about 10 percent increase in total volume of credit money. Production and prices responded, with a lag of about five months, production increasing 35 percent and prices rising 11 percent from the low point 145 in July, 1924, to the high point 161 in February, 1925 (Curve *J*). Agricultural prices made the greater gain.

Thus the System, which had brought on a deflation in 1923, brought on an inflation in 1924.

THE DEFLATION OF 1924–1925

The inflation policy of 1924 continued until October, when the holdings of securities reached $580 million. The open market committee then began the sale of securities, reducing their holdings $250 million by July, 1925 (Curve *B*). Gold exports started about the same time (Curve *A*). The member banks immediately began borrowing, and increased their indebtedness to the Reserve banks $750 million from August, 1924, to November, 1925 (Curve *D*). The commercial rate in New York rose from $3\frac{1}{4}$ percent to 4 percent (Curve *F*). The member bank reserves stopped their increase (Curve *C*), and the demand deposits declined and then increased (Curve *H*). Following these correlated

movements, the wholesale price level began its decline from the high point 161 (Curve *J*).

Thus the Reserve System since the war has conducted three cycles of inflation and deflation—the extreme cycle of 1919–1921, before they knew what they were doing; the cycle of 1921–1923, while they were learning what they were doing, and the cycle of 1924–1927 after they knew what they were doing.

STANDARDS OF RESERVE SYSTEM PRICE CONTROL

There remains the question of the standards which guide them in the exercise of their legal and economic powers. The present legislative standard is only the vague “accommodation of business and commerce.” This was supplemented in 1923 by their own indefinite standard, “the general credit situation.” Under this heading many factors may be taken into account, all of which require, more or less, the use of credit according to the judgment of the Federal Reserve Board and the Federal Reserve banks. All of these factors indicate a feeling of responsibility on the part of the leaders of the System for the different directions which inflation or deflation may take. I mention some of these factors which I gather from conversation with them or reading their publications and speeches. One is the movement of Stock Exchange prices; another is overproduction, especially agricultural overproduction; another is the movement of rents and real estate speculation; another is instalment buying; another is the movement of wages and the cost of living as measured by the movement of retail prices; another is a desire to return to the pre-war free-gold standard instead of continuing on the present post-war managed-gold standard; another is the menace of radical legislation; another is the movement of wholesale prices.

In considering all of these factors the composite of which is the elastic term, “general credit situation,” it is noticable that intelligent forecasters of business conditions have begun to qualify their forecasts by adding, “We do not know what the Federal Reserve System will do.” There is undoubtedly a need in the business and agricultural world, as well as in the political world, for definite knowledge of what the Federal Reserve System will do. On this subject, at the present stage of experience and research, many different opinions are heard, and I can give only my personal opinion that the Reserve System should hold itself responsible primarily only for the stability of the general average of wholesale prices (Curve *J*), and secondarily responsible for the other factors only in so far as they may be expected to swerve the average of wholesale prices away from stability.

A NEW COMMODITY PRICE INDEX NEEDED

If stability of the average of wholesale prices is taken as the guide of the policy of the system, then the first question is the weights to be given to each of the various commodities in making up that average. The index of the Department of Labor (Curve *J* projected to 1927 from Irving Fisher's weekly index) is based on 404 commodities, weighted according to the quantities of each sold upon the market. Other methods of weighting are the quantities produced or the quantities consumed.

None of these methods fits precisely the purpose of stabilization, which is that of justice between classes of producers. If justice is the purpose, then the weights should probably be a population weighting, each commodity being weighted by its proportion of the population engaged in the production of that commodity. If, for example, the growers of wheat are 5 percent of the total population whose products are sold at wholesale, then the fluctuations of the price of wheat should have only 5 percent of the total weight in arriving at the total change in the average index of wholesale prices. And so on with other commodities.

This scheme of weighting appeals to the public's sense of justice. It will help overcome the only menace suggested as a possible argument against a policy of stabilization—namely, the possible political influence of those whose prices are falling, in their effort to get control of the Reserve System and change all prices in order to raise the price of their particular commodity. If there is a known policy of maintaining a stable level of wholesale prices, and if each section or class of producers knows that it has a just weight, according to its numbers, then it is unlikely that the political influence of any class will be effective in breaking down the rule of stability. Stabilization of the price level may be expected to take and keep the Reserve System out of politics. In my opinion no other policy will do so.

Stabilization should be on the basis of wholesale prices, with only secondary regard to other prices, because wholesale prices are more quickly responsive to the operations of the system, and other prices depend upon wholesale prices. Stock prices are forecasts of profits which depend largely upon the movement of wholesale prices. Wages, retail prices and rents are largely the result of wholesale prices. Wholesale prices are employers' prices, and their oscillations determine the oscillations of employment and unemployment. Wages are not prices of commodities—they are the income of participants in production, and are no more entitled to be included in an index for purposes of stabilization than are profits, interest or rent, which are the incomes of other participants, all of them largely affected by the oscillation or stability of wholesale prices.

An index number of wholesale prices, weighted according to the population participating in production of each commodity, would seem to be a definite standard which all could understand, and which forecasters could rely upon in place of the present unknowable and indefinite standards of "accommodation to commerce and business" and

the “general credit situation.” Of course the preparation of such an index number would require the best economic and statistical ability of the country.

The Federal Reserve System has already all of the legal and economic power immediately needed, and all of the eminent banking ability needed to carry it into effect. It lacks only a definite standard of stabilization. This requires that the present managed gold standard shall be maintained, instead of seeking a return to the pre-war free-gold standard, to reach which would require considerable deflation of prices. It may require, too, that if there should occur a great flood of gold imports there may be needed further substitution of gold certificates for other currency. The present deflation of prices, however, beginning February, 1925, could be corrected as the similar deflation was corrected in 1924, by purchasing securities, then reducing the rediscount rates.

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RESERVE BANK CONTROL OF THE GENERAL PRICE LEVEL
A rejoinder

The Annalist 30 (July 8, 1927):43–44.

The criticism of Messrs Wissler and Comer, in *The Annalist* of May 13, on my article of April 1, involves partly questions of definition and partly questions of statistics, causation and purpose. I agree with them on what they call the "statistician's dilemma." The function of the statistician is to describe and reveal quantitative facts. He is not concerned with causal relationships. That is left to the economist who makes use of these statistical facts in attempting to trace relationships of cause and effect.

As to theories of cause and effect of credit and prices, there are, as is well known, two schools of economists. The extreme "commodity" theorists find causation on the demand side of the equation, in an existing "volume of trade" which gives rise to the needs of business to finance the marketing of existing quantities of commodities at existing prices. This demand for present buying power, they say, causes the banks to create an equivalent supply of demand deposits. But the extreme "quantity" theorists find causation on the supply side of the equation, in an existing "volume of money." This consists of the existing quantity of gold available, and of the existing quantity of banknotes or demand deposits "manufactured" by Governments or banks, independently of the volume of trade.

I do not know that any economist would consent to be classified as an adherent of either of these extreme theories of cause and effect, although Wissler and Comer try to force me into the extreme quantity theory, while they apparently commit themselves to the extreme commodity theory.

CAUSES LIE IN RELATIONS OF BUSINESS MEN WITH BANKERS

If we examine typical and actual credit transactions which constitute almost all of modern business, since very little gold or silver is used, we find that a credit transaction is really a single transaction with two sides, a commodity side facing toward future buying power to be derived from future commodity and money markets, and a money side facing toward the present buying power to be furnished by banks at what they deem to be the present discounted value of those promises to pay in the future.

The bankers do not merely supply buying power to meet existing needs of business on present commodity markets—they also participate with business men in determining how much shall be the future volume of trade in its two dimensions of future quantities to be produced and future prices to be paid on future commodity markets. These expectations thereupon become the demand of business men for the present buying power to be furnished by the banks. It is in these private negotiations and transactions of 30,000 bankers with millions of business men, encouraging or restraining the latter in their commodity transactions, that the theorist must seek his explanations of cause and effect.

If, now, 10,000 banks, controlling two-thirds of the commercial credit, instead of freely competing with each other for business, learn how, or are led, to act together at the same time and in the same direction in all parts of the country in their billions of credit transactions, encouraging or restraining those millions of business men, then the bankers' participation in the present and expected commodity markets becomes more pronounced.

CONCERTED ACTION OF BANKS THE CENTRAL IDEA

Messrs Wissler and Comer overlook entirely my central idea—this concerted action of 10,000 member banks, guided by twelve reserve banks and supervised by one Federal Reserve Board. My article was designed to show how this concerted action, as learned by experience, has developed into an effective system. It is a system analogous to what is known in labor circles as "collective bargaining." Its essential feature in this case, is individual bargaining by member banks with business customers, but under collective working rules enforced upon all the members, which place minimum and maximum limits on their individual bargaining. These I described briefly in my article. Had I attempted to cover the ground more fully, I should have recited the following instruments of concerted action.

INSTRUMENTS OF CONCERTED BANK ACTION

1. Practical monopolistic control of the monetary supply of gold, owing to the impoverishment of Europe and the need of paying to America nearly $1,000 million annually in gold or equivalent, as interest and amortization of public and private debts. Hence increasing power of control over the value of gold measured by changes in world price levels.

2. Impounding this gold so that it cannot be used directly by member banks as their individual gold reserves, but can become effective only in the form of Federal Reserve notes, gold certificates and member bank credit reserves. In the use of these, by concerted action, the Reserve banks can and do take the initiative as occasion requires. This is my distinction between a managed gold standard and a free gold standard.

3. Publicity and moral suasion in the form of published forecasts of financial authorities and private conversations with bankers as to the prospects of markets and business. If these forecasts of prices and quantities are optimistic, as in 1919, or if they are utterances of caution, as in 1923, they have a distinct influence on the business demand for credit. The Federal Reserve bankers do not engage in published forecasts, since changes in their rediscount rates and open market operations, where they take the initiative, speak more loudly than words. But they are continually in conference with member bankers and business men, who are, of course, eager to know what they think and are going to do.

These conferences, negotiations, publicity, encouragement and restraint, cannot be charted in a diagram, nor reduced to the statistical correlations of cause and effect demanded by Wissler and Comer, yet they are in fact the actual process by which 10,000 member banks act in concert in their dealings with millions of business men. If it were an acknowledged public policy of the Reserve System to maintain a stable wholesale price level, then its own publicity, and its reasons published at the time when action is taken, would be its most powerful instrument, for these would affect directly the forecasts and the demands of business for bank credit.

4. By choosing between the issue of Federal Reserve notes, as in 1919, and the issue of gold certificates, as more recently, the Federal Reserve System has the choice between an issue of currency that requires only 40 percent gold reserve and an issue that requires 100 percent gold reserve. The former is a greater power of inflation and deflation than the latter, while the latter suggests caution by making the impounded gold reserve seem smaller.

5. Open market operations, Messrs Wissler and Comer do not seem to gather the distinction between a private bank's investment in securities, when commercial loans are not in demand, and the Federal Reserve Banks' investment in securities when member banks are not rediscounting. The purchase or sale of the latter augments or diminishes member bank reserves by augmenting or diminishing the Reserve bank's indebtedness to member banks. The former does not affect member bank reserves—it merely shifts balances. The Reserve banks have learned to buy or sell securities regardless of the demands of business or their own profits, but the member banks shift between

investments and commercial loans according to the demands of business. This failure to distinguish between a member bank and the Reserve banks as a system is, however, excusable, for the distinction was not learned by the bankers themselves until the experience of 1922–1923, as I showed. Governor Benjamin Strong of the Federal Reserve Bank of New York and Chairman of the Open Market Investments Committee, described, in 1926, this experience in full, and the resulting policy of preparing the market, by open market operations, for the changes in the rediscount rates. His testimony is found in the hearings on Congressman Strong's Stabilization bill, before the House Committee on Banking and Currency, April 8–13, 1926.

6. Rediscount rates. In 1919–1920 the inflation of prices occurred largely through issue of Federal Reserve notes because of low discount rates too long maintained. After 1921 the relatively minor inflations and deflations were promoted or checked by open-market operations and by changes in the rediscount rates.

7. Gold imports. By means of the foregoing instruments of control the system has operated *against* gold imports to prevent inflation, as in 1923; and *with* gold imports to produce inflation, as in 1924.

8. Foreign borrowings. These took the two forms of unfunded debts in 1919–1920, when the Reserve system cooperated to produce inflation by maintaining low rates of rediscount; and the funded debts of 1921 to date, with which the system cooperated, by open market purchases and by reducing the rediscount rates, to produce the inflation of 1924. But the system operated to prevent inflation in 1923 by open market sales and raising the rediscount rates.

9. Commodity prices and security prices. Apparently the first effects of open market and rediscount operations appear upon the stock markets and afterward upon the wholesale commodity markets, and still later upon the retail and labor markets. This is undoubtedly a matter to be considered in any program of stabilization of the general level of prices.

10. Timeliness. The essence of administrative ability is to do the right thing at the right time, the right place and in the right amount. Sometimes the system works *with* forces which they cannot control, sometimes *against* forces which they cannot control. This is a matter of experience and administrative ability. No theorist can advise them what to do in the hourly emergencies that arise. He can only admire the high banking ability which has learned by experience rather than theory how to work with or against the complex forces of demand and supply in the administration of their collective control.

PURPOSE AND THE DEFINITION OF WORDS

Other considerations respecting cause and effect might be mentioned. But I will say something about purpose and the definition of words. I use the terms "inflation and deflation of prices" without any theory whatever of causation. The terms indicate merely a statistical description of rise and fall of the general price level, in contrast to the

description of a stable price level. Inflation, deflation and stability of the average price level are my statistical statements of fact, to be afterward explained by investigation of all the accompanying facts that may possibly enter into their causation.

These statistical statements themselves, however, may be open to criticism, for they are constructed, not by blind statisticians but by economists for a purpose, and this purpose includes theories of cause and effect. For this reason I indicated in my article a criticism of various index numbers of prices used by statisticians, which, according to my theories of purpose, do not represent the relative importance of several factors.

I would exclude wages, retail prices, rents, stocks, bonds, etc., and would employ solely wholesale prices of freely producible commodities, because they are fairly responsive to the operations of the banking system, and because the stabilization of wholesale prices, for reasons given, seems to me to be important for the public purposes of justice between creditor and debtor, stability of employment, the burden of taxes, etc. Carrying out this idea of public purpose, I suggested a system of "weighting" on the basis of proportions of population engaged in production of these commodities.

I believe this is what all statisticians do, for economic facts do not lie around exposed, like layers of rocks—they are first *selected* and then *weighted* according to the purpose which the statistician or economist has in view.

"INFLATION" AND "FIAT"

It has been shown, however, that there is a remarkable agreement among different compilations of index numbers of wholesale prices, and I used the compilation of the United States Bureau of Labor as representative of them all. Assuming that the bureau index number is typical, my terms "inflation," "deflation" and "stability" of prices are merely descriptive of a series of related facts, stripped as nearly as possible from purpose of causation. When Messrs Wissler and Comer distinguish "true inflation" and "fiat" they are injecting a meaning of casuation and purpose into the word "inflation" which I thought I had avoided. I distinguish between the *fact* of inflation or deflation and the *causes* of inflation or deflation.

In fact, what they call "fiat" is evidently one of the items I had in mind when I described the legal and economic collective power of the Federal Reserve System. Only I would have to call "deflation" also a "fiat," as well as "inflation," in so far as I traced the rise or fall, or the prevention of rise or prevention of fall, of prices in general to the collective action of 10,000 member banks, the twelve Reserve Banks and the Federal Reserve Board acting under the authorization of Congress, for Congress means law and "fiat" means law. It is generally agreed, I believe, that the System has greatly "moderated" the extreme fluctuation of prices since 1921. If so, then its action was "fiat," that is, law and administration, according to my understanding of Wissler and Comer, both when it stopped the inflation in the beginning of 1923 and when it augmented the inflation in 1924.

SOME COMMENT ON "FIAT"

Apparently their word "fiat," however, is limited to mean the use by the Federal Reserve System of the legal power granted by Congress in order to raise prices excessively, for their two illustrations of "fiat" are instances of what the system actually did in 1919 and what it might now do with its enormous impounded gold reserve.

They say it was "true inflation," or fiat, when the Reserve System forced Government securities "sans goods" into the investing public's hands, afterward "dramatically deflated in 1921." By the same method, they say, a similar inflation "may conceivably" be precipitated again, leading, of course, to later disastrous deflation.

The other possible "inflation" or "fiat" which they mention is similar, for it is the "release of gold as the commodity base of a Federal Reserve note currency which so soon as its commodity content is depreciated by its supply outstripping goods becomes to that extent fiat." This statement, as I understand it, means that with an existing gold reserve of about 80 percent against Federal Reserve notes the system could greatly increase the issue of Federal Reserve notes, as it did in 1919–1920, thus bringing the gold reserve down to the legal minimum, 40 percent. This would be "true inflation" and "fiat," they say, because the value of the "commodity content" of gold would be depreciated if the notes payable in gold on demand outstripped the production of goods.

MUST "FIAT" MEAN CONCERTED ACTION?

I wonder why it should be called "fiat" when inflation is brought about by concerted action of 10,000 member banks united in the Federal Reserve System, as they say it was in 1919–1920; and should not be called "fiat" if it were brought about by free competitive action of the same 10,000 banks acting each on its own initiative. If there were now no Federal Reserve System, and if all of the great quantity of gold coming into this country could be freely used by individual banks competing with each other for business, by reducing interest rates and increasing credits to customers, is it not reasonably certain that these banks, acting competitively, would cause an inflation of prices quite similar to that caused by the concerted but misdirected action of 1919–1920? What is produced by concerted action Messrs Wissler and Comer would call "fiat." What is produced by individual action they would call the "natural law of supply and demand."

All of this goes to show that they agree with me on the facts of the enormous legal and economic power of the Federal Reserve System over the general price level. The only essential difference between us is in the meanings of words. By mere definition they exclude the inflation of 1919–1920 as not banking, but "fiat." And they exclude, as fiat also, any collective action by which either the expansion of note issues, or presumably the expansion of member bank reserves by open market purchases, would "outstrip the

supply of goods." They thus practically reduce all the concerted action whereon I based my article and wherein, as is well known, the Reserve System takes the initiative, to the one word "fiat." What I call concerted action they call fiat.

33
LEGAL AND ECONOMIC JOB ANALYSIS

Written with E.W.Morehouse. *Yale Law Journal* 37 (December 1927):139–178.

Examination of legal and economic literature reveals two different views of job-transactions. The prevailing legal concept seems to be that the job is a contractual relationship between two individuals having an equal footing before the law. In contrast, the prevailing industrial concept of the job seems to be that of a bargaining relationship between unequal individual members of groups, concerning the disposal and conditions of opportunities to work. Both views grow out of past experience. The legal view originated in the customs and practices of master and servant; these have been modified here and there as the more up-to-date customs of employers and employees have been deemed sufficiently general and certain to warrant incorporation into the law. The contract of a master with his servant was like the contract between the buyer and seller of a commodity. This parallel is still dominant in the more modern law of employers and employees, and the courts do not seem inclined to permit a classification which distinguishes the labor contract from the commodity contract. Economists, however, are familiar with the distinction that in the labor contract the worker delivers himself on the job, whereas, in the commodity contract, the seller delivers to the buyer something separable from the person.

Courts and attorneys seem to visualize the worker in a world of equal legal opportunities, whereas the worker experiences only unequal, limited economic opportunities. As long as the law sets up the same legal obstacles to complete freedom of contract for employers and workers, the law need not, indeed cannot, concern itself with what the parties do to each other.[1] But the difference in bargaining power causes the economic consequences of identical legal rules to vary widely for employers and workers.[2] In other words legal equality and economic equality are not identical.

Another distinction centers in the *res* of the job-transaction. Before the law the job-contract determines legally enforceable rights and duties[3] supported by remedies granted by the courts. But to the average worker the job-bargain determines what kind of living he can get in the struggle for life. Hence, to the worker, the opportunity of getting the courts to enforce employers' promises is subordinate to the opportunity to get work on the best terms possible.

It is possible also to discern a difference with regard to the time element. The law looks to the past to find legal validity for the rights and duties of the contract, and to find

what rights and obligations were mutually exchanged. The parties themselves look to the future to find economic security for their expectations.

The above statements are but various ways of expressing the clash between judicial and industrial practices, customs, and working rules—a clash which frequently is argued back and forth in the courts. From the broadest social point of view, in analyzing the job we deal with the task of harmonizing legal and economic institutions. How does the law affect economic behavior? How can legal customs be modified to meet the practical needs of the parties enlisting the aid of the courts? From an economic point of view we observe that the clash between the working rules of employers and of workers, when submitted to the law, results frequently in decisions which aggravate the problems of efficiency, good will, and stability.

The experience of the Rochester men's clothing market from 1919 to 1922 is brought forward as an illustration of the concept of the job as a bargain and of the process of stabilizing the bargaining relations between employers and employees by the development of working rules through extra-judicial arbitration machinery. The footnotes will show corresponding legal opinions.

There are at least three reasons for the selection of the period 1919–1922. (1) During these three years the Rochester clothing market experienced both prosperity and depression. (2) The jurisdiction of the arbitrator was broad[4] and reports of cases were relatively complete. (3) After 1922 the jurisdiction of the arbitrator was narrowed[5] and reports of cases were so brief as to make it impossible to analyze the situation from the published record alone.

From 1919 to 1922 bargaining was carried on under two agreements.[6] The first and more or less informal agreement was negotiated in February, 1919, between a group of employers, organized as the Rochester Clothiers' Exchange, and the Amalgamated Clothing Workers[7] while the latter organization was engaged in strikes to secure the forty-four-hour week and market agreements in Chicago and New York. This agreement, effective from April 1, 1919, to May 1, 1920, provided for the "open shop," collective bargaining through shop chairmen or outside representatives of the union, a procedure for handling complaints, arbitration of unsettled disputes by a jointly chosen and jointly paid arbitrator, the forty-four-hour week, and negotiation or arbitration of wage scales.[8]

A two-year agreement followed in May, 1920.[9] This agreement carried on most of the principles worked out during the first year, including the open shop feature, and established some new principles. It included specific hiring, discharge, and equal division of work clauses; recognized the employer's right to make changes in manufacturing methods; established the principles of a minimum wage and the abolition of home work; created administrative machinery for handling disputes, exercising sanitary control of shops, and developing supplementary rules governing new situations; and specified the procedure by which changes in wage levels and wage rates should be made. The agreement briefly stated the general principles according to which bargaining should be carried on from day to day. Being in general terms, it was inevitable that disputes over the application of the agreement to specific conduct should arise. The process of adjusting these disputes required continuous collective bargaining and arbitration machinery and resulted in new interpretations which amplified the general rules of the agreement.

The machinery of collective dealing was simple. The employees in each shop elected a representative to take up complaints with the foreman or labor manager, in the first instance. If no agreement was reached, the shop chairman called in a business agent of the union. If still no agreement was reached, the next step was to refer the matter to the Labor Adjustment Board of the market. This board was composed of the business agents of the union, the labor managers of the various firms in the Clothiers' Exchange, and an "Impartial Chairman" selected and paid jointly by the union and the employers' organization. Representatives of employers and representatives of workmen usually voted as a group; in case of a tie the Chairman cast the decisive vote. The Board had final jurisdiction and a decision of the Impartial Chairman was binding on both parties. In practice the Chairman functioned as an arbitrator having both original and final jurisdiction.

The employers had agreed to give up a measure of their control over jobs. But even under this general concession an individual worker in Rochester found his job-opportunities menaced by several risks: (1) the risk that a non-union or out-of-town worker might get a job ahead of him; (2) the risk that tenure of the job (continued opportunity to earn a living) might be terminated by his employer, other employers, or other workers; (3) the risk that opportunities to work might be withdrawn for a longer or shorter period; and (4) the risk that opportunities to capitalize skill and experience might be destroyed by changes in manufacturing technique.

To reduce the first risk it was agreed to establish for Rochester union workers preferential access to opportunities to work. To modify the second and third risks it was agreed to establish detailed rules indicating when and under what circumstances occupancy of the job might be terminated, either permanently or temporarily. The fourth risk could not be eliminated but its harsh effects might be softened. The causes which are subsequently analyzed are grouped according to the following scheme:

1 Access to job-opportunities

2 Tenure of job-opportunities

(a) Individual discipline

1 Workers

2 Officials

(b) Group discipline

(c) Lay-off and permanent reduction of force

(d) Introduction of machinery.

I
ACCESS TO JOBS—HIRING TRANSACTIONS

The hiring clause of the agreement stated:

> The power to hire shall remain with the employer, but in cases where discrimination on account of union membership is charged, the Impartial Chairman shall have the right of review; and if facts are brought before the Impartial Chairman that appear to indicate that the labor policy of any house is calculated to undermine the union, he shall have the power to review that policy.[10]

On its face this clause established an open shop in which union men and non-unionists should receive equal treatment. There were, however, two supplementary understandings which made this clause more specific. One was that the first two weeks of employment would be regarded as a probationary period during which the employer might discharge freely; the other was that during unemployment employers would give opportunities to work to Rochester workers in preference to out-of-town workers.

The earliest cases arise from charges of blacklisting.[11] In Case 64[11a] the union complained that a worker was refused employment after two weeks' work because a labor manager told the employer that the worker could not be hired.[12] The hearings disclosed that the worker had been fired after several days work, re-employed within a half a day, worked two weeks, and was then let go at the instigation of a labor manager. There were no charges that the worker had left his previous employer without a week's notice. In the absence of such charges, the arbitrator ruled that the worker could not be denied employment, and ordered him reinstated with pay for time lost.

In Case 115, a worker gave notice of quitting, intending to get a custom job at higher wages. This opportunity was withdrawn at the request of some member of the firm for which he had worked. The worker subsequently obtained another job from which he was suspended at the request of a labor manager. Complaint was therefore made of unjust discrimination in hiring. The arbitrator ruled: "The worker violated no agreement when he gave a week's notice because he had a better job." Since the arbitrator was unable to fix the responsibility for loss of time on any one individual, the Clothiers' Exchange was ordered to compensate the worker.

In Case 122 a worker was discharged after working one week, at the request either of a former employer or the Clothiers' Exchange.[13] The arbitrator ruled that the employer's right to discharge during the probationary period was not absolute, but limited by the "spirit and purposes of the agreement." In the language of his decision:

> Such discharges whether made during the first week of employment or at any other time, cannot be approved…The right to discharge during the first two weeks must be limited by the spirit and purposes of the agreement. If this right were held to be absolute so that an employee who has done nothing wrong, and whose work is satisfactory to the employer, may be discharged at the instigation of other employers, then a blacklist of the worst kind would be legalized. At the same time the right of the Union to tell its members where they may or may not work would also have to be considered an absolute right, so that it might keep workers from going to certain factories and thus tie up shops as effectively as if a strike were called.[14]

In Case 139 a worker had quit without notice, and the contractor who employed him had not insisted upon a week's notice. Subsequently another employer refused to hire this worker because he had not given a week's notice to the contractor. The worker lost time until the contractor notified the Exchange that he had acquiesced in the quitting without notice. This was held to be an invasion of the worker's rights.

> Employers who give references on any employees who leave them must be careful to tell the exact truth[15] as to whether they quit with or without notice and no one has a right to interfere with any workman getting another job.

In Case 210 a worker was hired by a foreman and told to report for work the following day, at which time he was refused employment because he had worked for and quit the firm before. There was no evidence of blacklisting.

> Under the circumstances the Chairman does not think it wise to reinstate the man, as the firm could discharge him again within the two weeks' probationary period.

Three decisions pertaining to preference in hiring[16] during slack employment followed the above cases. In two of the three the transaction also involved alleged discrimination against non-union men.

In Case 230 a firm hired an out-of-town sleeve sewer when two former sleeve sewers of the same firm were unemployed. The union contended that with Rochester sleeve sewers out of work, the firm was obligated to hire one of them in preference to the out-of-town worker, according to the informal understanding. The arbitrator found that the firm had sent for both local workers, one of whom quit and the other left town. He therefore ruled that the firm had fulfilled its obligations under the informal agreement and was privileged to hire the out-of-town worker.[17]

In Case 455 the union complained that a presser, who had been expelled from the union, was hired by a firm when there were other local seam pressers out of work. The firm argued that the worker in question had had Rochester experience before leaving town for Europe and that the union had not filled the firm's requisition for a presser. The

ruling was that if the union could furnish a presser at once,[18] he should be given prior consideration.[19]

In Case 801 the union complained that a recently hired off-presser had no right to the job because of unemployment in that operation. The worker had been an assistant foreman in another house and hence not a union member. Before that he had worked as an off-presser for the employer who had just hired him. The arbitrator cited the "unwritten understanding that when there is unemployment in any craft no worker of the same craft shall be given a job if he does not already belong to the industry in this market." The worker in question was not a learner[20] nor a non-resident. He had "belonged to the industry for years both through learning his craft in it and by employment" and hence "under the agreement he has a right to this position."[21]

The hiring clause, minus the supplementary understandings, sanctioned the prevailing practices of employers, with the exception of the limitation upon the privilege of discriminating on account of union membership. The purpose of this limitation was obviously to equalize bargaining strength in order that the agreement might work successfully. This is a valid object when reached by a trade agreement, but not valid as a legislative object, enforced by fine or imprisonment.[22] A clear case involving only the fact of discrimination on account of union membership did not arise. It was one of the elements in Cases 455 and 801, one ruling favoring the union, the other the non-union worker.[23]

The blacklisting cases involved chiefly the problem of justifiable interference with employment by third parties.[24] It appears that a worker's access to employment opportunities was protected from arbitrary and unreasonable interference by other employers, despite the apparently large scope of the employer's privilege to discharge at will during the two weeks' probationary period. Such interference was justifiable if for the purpose of protecting the common rule of giving a week's notice before quitting (Cases 64, 115, 119, 139). Otherwise it was "malicious" in that the interference had no clear relation to legitimate trade advantages of the employer, and bad policy because it tended to provoke retaliatory acts on the part of the union (Case 122).

The preference in employment cases involved third party interference of a different nature. In these cases the union sought to interfere with the reciprocal access to the labor market of employers and actual or alleged out-of-town workers. By the informal market understanding the union hoped to protect local workers from the potential or actual competition of out-of-town workers. In effect, therefore, the parties agreed to a measure of restricted access to market opportunities in the interest of a strengthened union and a more or less stabilized market.[25] But the interference with a free flow of labor in and out of the Rochester market did not, of course, extend to the point of an absolutely closed market[26] (Case 239), nor a closed union. The interpretation of the rule justified union interference with the job opportunities of non-resident workers (Case 230), those temporarily non-resident (and non-union) (Case 455), and resident apprentices (Cases 584, 602, 692), but not of a resident worker who happened not to be a union member (Case 801).

II
TENURE OF JOBS

(a) Individual discipline

1. Workers

The discharge clause of the agreement (Sec. 4) was as follows:

> The power to discharge and suspend employees remains with the employer, but it is agreed that this power will be exercised with justice and due regard for the rights of the workers; and if any worker feels that he has been unjustly treated in the exercise of this power, he may appeal to the labor adjustment board hereinafter mentioned, which shall have the power of review in all such cases.

The understanding about discharges at will during the first two weeks of employment amounted to a subtraction from this clause.[27] After the probationary period discharges had to be justified[28] and were subject to the week's notice rule[29] unless the offense warranted summary dismissal.[30]

Since the agreement did not specify what were considered just causes, we have to seek the precise scope of this clause in the decisions of the arbitrator. We find that a worker was not to be discharged on account of poor *quality* of production[31] when he was not given at least two week's fair trial on the new work (Case 296), when he was old (Case 159), when the shop chairman's cooperation in securing improvement was not solicited (Cases 328, 607, 617, 811), when charges of incompetence were made after a lay-off to avoid re-employing the worker (Cases 38, 285, 338), when a foreman relied on threat of discharge to bring about improvement (Cases 318, 582), when the worker received less than the scale of wages (Cases 88, 148, 159), and when the worker was not given fair warning of his deficiencies (Case 38). However, a worker was justifiably discharged for poor workmanship when he had been given a reasonable trial (three months in Cases 161 and 588; two weeks in Case 296), or when he clearly could not do the work for which he was hired (Cases 39, 279, 315).

Similarly a worker was not to be discharged for *low* production when paid less than the scale (Cases 88, 159), when production records did not prove the employer's case (Case 384), when the cooperation of the union was not solicited (Case 617), or when there was an adequate remedy in measured production (Case 332). Nevertheless, a worker was justifiably discharged for *low* production when production records clearly proved the case (Cases 315, 588, 617, 645), when an investigating committee representing both sides agreed a fair day's work for the wages paid was not being given (Case 153), when the worker deliberately restricted output (Cases 325, 463), when the firm had used reasonable efforts to train the worker (Case 161), or when the worker was unable to earn even the minimum wage on fair rates (Cases 617, 645).

Another group of cases concerned the employer's use of the discharge privilege in order to maintain shop morale. An employer was justified in dismissing a man who used physical violence in the shop (Cases 205, 226, 474), who smoked in the shop in violation of a clearly understood rule (Cases 35, 422), who was dishonest (Case 340), who refused to go to the labor manager to settle a dispute (Case 194), who refused to obey reasonable orders of the foreman (Cases 35, 232, 422), who refused to obey orders of foreman and shop chairman (Cases 85, 715), who used indecent language in the shop (Case 85), who interfered with other workers (Cases 75, 123, 243, 555, 680), or who was repeatedly tardy and quarrelling with other workers (Cases 75, 555). On the other hand, there was not sufficient cause for discharge when the smoking rule was not observed equally by members of the firm (Case 656), when the actions of the employer were a provocation to the worker (Cases 205, 257, 270), when "bad times" and the difficulty of finding another job made discharge for loafing unduly severe (Case 208), when the worker was comparatively young (Case 130), or when the employer was unable to prove his charges (Case 215).

Treatment of discharges for absence without notice to the employer varied according to the circumstances in each case. There was a market understanding to the effect that the worker must notify the firm within forty-eight hours if he wished to retain his job-privileges. In an early case this understanding was interpreted by the arbitrator to mean two working days, i.e. the forty-eight hours should be reckoned from the time when the worker ordinarily would have reported for work (Case 27). If a sick worker relied upon a friend to notify the firm, he was liable to discharge if the friend could not clearly prove notification within the time limit (Case 147). Yet extenuating circumstances were recognized, as when an employer had recently raised wages despite irregular attendance (Case 251), or when a worker mistakenly believed Jewish holidays were excluded from consideration (Case 251), or the long service of employee (seven years) justified giving him another chance (Case 456). Where there were reasonable extenuating circumstances, the extreme penalty of discharge was sometimes modified to suspension (Case 251).

In discharges made necessary by overmanned sections, the employer was given considerable latitude, provided he exerted reasonable efforts to keep the excess number of workers employed, notified the union of overmanned sections, and gave the union a chance to find other jobs for the displaced workers (Cases 121, 385, 496, 594).

Similarly, in the cases involving transfers from one job to another, the worker "has a right to object to a demotion," but if the transfer was reasonable, such as to fill out a short-handed section (Case 442), the worker had no justification for refusing. However, where the transfer was from week work to piece-work, two periods must be distinguished. Up to May 3, 1921, the arbitrator protected the worker from being forced to accept piece work against his will (Cases 38, 193, 228). After that date, however, the management was given the privilege of transferring any worker or operation to piece-work (General Award, May 3, 1921, and Case 535), provided the operation was susceptible to measurement (Case 529) and rate and earnings were fair compared with those in other firms in the market.

Discharges after a lay-off were generally not approved unless exceptional circumstances could be shown. In one case a worker was not rehired after a lay-off because his operation was abolished. This was held to be "no just cause for dismissal because the agreement, while leaving the employer free to change operations as he sees

fit, provides that the worker should not suffer as a result of such changes" (Case 306). Similar positive obligations were imposed on the employer to teach apprentices, and an employer was not warranted in discharging an apprentice if this obligation was not reasonably performed (Cases 98, 739). Finally, we may note that an employer was not justified in discharging a worker because he exercised his "right" to ask for increased wages (Case 100) or the minimum wage (Case 752).

Penalties for unjustifiable conduct varied with the seriousness of the offense and the circumstances of each case. The more serious offenses, which constituted just cause for discharge (generally associated with efficiency of production) were penalized by loss of jobs. Lesser offenses called for suspension for a certain time or reinstatement *without* pay for time lost in hearing the case. Where the employer was wholly unjustified in his disciplinary action, the worker was reinstated *with* pay for time lost, which amounted to an award of compensatory damages without the worker's duty of mitigation.[32]

A few striking cases reveal more clearly the process of changing the working rules by arbitral interpretation. Most of the above cases involved the relations of economic opposites acting as individuals; the union agents appeared as attorneys for the individual worker as the labor manager represented the employer. However, in the court reports are many cases involving relations with economic collaterals (third parties). The following arbitration cases really fall into this class.

Two cases involved the difficult question whether an employer could be required, under the agreement, to discharge an employee guilty of an offense against the union.[33] The arbitrator reached opposite conclusions. In Case 149 the grievance committee of the union disciplined one of its members by a fine and suspension from the shop where he was working. The employer denied the right of the union to require a firm to discharge an employee simply because a violation of union rules had occurred. The union complained that the management was encouraging its employees to defy the union, but specific charges to this effect were not made and the arbitrator therefore ruled this matter out of consideration. On the main question whether the union could discipline its members by removing them from the job, the arbitrator said:

> There is no question that the union must have power to discipline its members. If it cannot do that, then it cannot force them to live up to agreements made by the union with the employers. However, in meting out discipline to its members the union must do it according to the laws of its own organization.[34] It can fine them, reprimand them, suspend or expel them [i.e. from the union] and impose any other penalty authorized by the union's constitution and by-laws which they agreed to obey. But to make suspension by the employer a penalty imposed by the union, is going beyond the union's power of discipline and asking the employer to act in the union's place. The employer is, therefore, within his rights in refusing to take any such action…it cannot be held that the union has the right to order the employer to suspend such a member from his job.

In Case 451 a worker was suspended from the union for failing to pay his dues. The employer refused to discharge the man at the request of the union, relying on the ruling in Case 149. The arbitrator ruled:

> The dues are the taxes required to maintain the governmental agencies for the industry set up by the agreement and any individual in whose behalf the agreement was signed who avoids the payment of the tax is violating an obligation assumed by him when the membership of the union voted to accept the agreement…In a previous case [149] it was decided that, "to make suspension by the employer a penalty imposed by the union is going beyond the union's power of discipline and asking the employer to act in the union's place…." In this case the union has already suspended the erring member before asking for his discharge and could go no further in disciplining him without striking the shop…. Since the agreement ties the hands of the union in this respect [stoppages], it must afford to the organization a legal method of enforcing its just disciplinary measures which will be as effective as the refusal of its members to work with an expelled member…Unless such a legal method of enforcing disciplinary rules is provided, the agreement would have the effect of weakening the union, members could defy the organization with impunity, and the attempts of the Labor Adjustment Board to hold the union responsible for compelling its members to live up to the provisions of the agreement and to the decisions of the Impartial Chairman would be futile…The union may file a complaint with the employer that the member has been so suspended, and if the suspension was regular and not in violation of the agreement, it is the duty of the labor manager to suspend the member from work until he has obeyed the proper disciplinary measures imposed on him. If the labor manager has reason to feel that the disciplinary action taken by the union has not been regular in accordance with its own written rules or has been in violation of the agreement, then the labor manager may refuse to suspend the worker [until the case is reviewed by the Impartial Chairman].[35]

In the first of these two cases X (the grievance committee of the union) penalized Y (a union member) for breach of union rules by a fine and termination of Y's contract with Z (his employer). The second half of the penalty, however, could be imposed only by inducing Z to suspend Y. When Z refused, justifying himself by the agreement, two courses of action were open to X: (1) withdraw Y's fellow workers in that shop; or (2) persuade A (the arbitrator) to construe the agreement so as to put moral pressure on Z to suspend Y. The first alternative of direct action was a clear violation of the agreement;[36] the second alternative failed because X had not exhausted all the remedies in its power.

In the second case X sought to compel Y to pay his union dues by suspending him from the union *and* terminating his contract with Z. Thus X asked Z to cease dealing with Y as a delinquent ex-member of the union. When Z refused, A exerted his moral pressure to make Z conform, using the argument that since X had given up the alternative of direct action and had exhausted its own remedies against Y, Z was morally obligated to conform to X's request. In the one case, inducing the termination of labor contract was not "lawful," in the second case it was justified to keep the agreement a going concern and to avoid a direct violation by the union.[37] It should be noted that X's activity did not deprive Y of all opportunities for employment in the locality, although, if the conduct

were repeated with each subsequent Rochester employer of Y, the effect might well have been to drive Y out of the market.[38] The point of interest in the arbitrator's decision in the second case is that conformity to the rules of the union is a legitimate trade interest of all members of the union and justifies interfering with the erring members' vested rights to the job.

2. *Discipline of officials*

Cases involving discipline of employers and union officials form a separate group, because the power of discipline was taken away from the parties directly concerned and lodged with the arbitrator. The usual method of union discipline of employers, i.e. stoppage of work, was taken away by the agreement (Sec. 6). The employer's power to discipline shop chairmen was transferred by supplementary understanding to the labor adjustment board, which, in practice, meant the arbitrator (Sec. 9).

Several cases involved the fitness of a shop chairman who is the union agent on the job, elected by the workers in the shop. The earliest (Case 9) arose when a firm refused to reinstate a shop chairman who had called a shop meeting during working hours and who had struck a fellow worker. The facts were admitted by the shop chairman, who entered a plea of self-defense. The arbitrator stated that his offenses were against his fellow workers for the assault and for loss of time, against the union for violating union rules, and against the employer for causing a stoppage of work. "The main responsibility is on the union to see that men of responsibility and judgment are selected as shop chairmen." Lacking these qualities, the worker was removed as shop chairman, though reinstated as a worker, and the union was ordered to impose a fine of not less than $10.

In Case 71 a firm complained that a shop chairman fomented a stoppage to bring pressure on the employer to discharge an inexperienced off-presser hired in violation of an alleged understanding in the shop that off-pressing vacancies would be filled by promoting under pressers. The arbitrator said it was "quite evident that the shop chairman did not understand his duties and that the pressure violated the agreement with the employers." For this violation the pressers were ordered to make up the time lost by working overtime at straight pay. As for the shop chairman who "deliberately intended to bring pressure on the employer by means of a stoppage rather than to take his complaint up through the union," the arbitrator recommended that the union discipline the shop chairman for neglect of duty.

In Case 82 a shop chairman was suspended by the labor manager for stirring up trouble in the shop. The shop chairman counter-charged failure of the management to cooperate. In the hearing it developed that the shop chairman had transacted union business during working hours and had insisted on the discharge of employees whom the firm had a right to employ. Witnesses for the shop chairman testified to the lack of cooperation on the part of the management. The arbitrator felt that there was insufficient cause for discharge, but if the shop chairman continued to invade the rights of others, whether of fellow employees or management, he would be disciplined upon proof of the charges. Hence he was reinstated without pay for time lost while suspended.

In Case 111 the fitness of a shop chairman was challenged on four grounds: (1) he did nothing to prevent stoppages, (2) refused to let two basters continue work when others stopped work, (3) spent half a day on a case involving an assistant foreman, and (4) took

up complaints at all hours regardless of the definite time fixed for such business. After hearing the evidence the arbitrator ruled:

> It is quite evident that he is too young and too inexperienced to hold such a responsible position. A shop chairman is an officer of the union just as much as a business agent or an organizer. It is his duty to tell members they cannot stop working when the union agreement provides against it. He should know that it is no part of his business to look after the interests of assistant foremen; and when members bring complaints during working hours, he should be strong enough to tell them to come to him at the regular times fixed for receiving complaints.

The arbitrator therefore advised the union that the shop chairman was unfit for his office and a successor should be elected.

These early cases pricked out the methods of handling the discipline of union officials in the shop. Thus in Case 382 the arbitrator could say: "The rule is well established in the market that the labor adjustment board has authority to discipline a shop chairman and not the labor manager," and, applying that rule, reinstate a shop chairman who had been suspended for calling the foreman a liar and refusing to withdraw the remark or apologize, because evidence showed both sides at fault. Similarly when an employer refused to listen to a shop chairman's complaints about division of work, he could not have him removed for ordering a worker not to do certain work in defiance of the foreman's orders (Case 561). On the other hand a shop chairman should be removed from office for instigating a stoppage to force the firm to hire his brother-in-law because, "Shop chairmen who ask personal favors of a firm show by that fact that they are unfit for the responsibilities of their position" (Case 501). In another case a shop chairman took part in a stoppage caused by the employment of non-union electricians to install electric fans. No union representatives appeared at the hearing, whereupon the arbitrator censured both the shop chairman and the union for "failing to perform their plain duty under the agreement." (Case 473).

The offenses of the employer requiring discipline were generally of three types: (1) insulting union officials; (2) insulting workers; or (3) flagrant violations of the agreement. Insults to union officials varied all the way from refusing to deal with business agents (Case 179) to assaulting a discharged shop chairman when he came to get his pay (Case 132), and the penalties varied from a reprimand by the arbitrator (Case 207) to a $50 fine (Case 220). Similarly where the offense was an insult to the workers, sometimes involving a walkout of the shop in protest (Cases 189–190), the penalty was usually a fine, depending on the seriousness of the offense [insult, racy and abusive language (Cases 197, 445), violence and foul language (Case 613)], although in one case (205) a firm was warned that a repetition of the offense would require the discharge of the foreman.

For a clear violation of the agreement the penalties had the elements of a boycott or threatened boycott. Thus in Case 638 a firm sent work to an unregistered contractor, claiming that this was permissible because this contractor was in the same building where a registered contractor used to be. The arbitrator ruled:

> The excuse offered is too flimsy to be taken seriously. The firm was ordered to withdraw the work [i.e. from the contractor] immediately and must stop all such subterfuges in the future for avoiding their responsibilities under the agreement.

Again where a contractor failed to abolish home work, or pay the minimum wage and time and a half for overtime, he was ordered to live up to the agreement or be removed from the list of approved contractors (Case 658). In Case 741 a fine was imposed for sending models to an unregistered contractor, and in Case 786 a contractor was removed from the list of registered shops where work might be sent because he refused to reinstate a shop chairman when instructed to do so by the arbitrator. Removal or threat of removal from the registered list was a serious blow to a contractor's business because of the difficulty of making connection with firms outside the Exchange.[39]

In all these cases the arbitrator, as joint agent of the associated employers and workers, interfered with the probable expectancies of union officials, employers, or workers. The extent of such interference is indicated by the penalties.[40] The greatest interference was undoubtedly that of inducing contractors or firms to conform by shutting off access to a market (which in one or two cases may have been actually a breach of contractual relationship) or threatening to do so.

(b) Group discipline—restraints of direct action

Lockouts and stoppages (i.e. strikes) occurred despite the clause of the agreement (Sec. 6) prohibiting them. In dealing with these situations the arbitrator worked out certain methods and principles which may be illustrated by a few cases.

In Cases 151 and 154 a stoppage occurred as an outgrowth of the union's attempt to have the firm discharge a worker for violation of union rules. The union charged the firm's representatives with encouraging defiance of the union. The firm counter-charged that the shop chairman aided and connived in the stoppage. The evidence of the union was that at the time of the stoppage the foreman told the delinquent union worker to stay at work. This was held to be insufficient evidence to prove the union's charges, for the employer was merely protecting his rights. The disposition of the case by the arbitrator is shown in the following quotation:

> Considering that the agreement between the union and the manufacturers is about to expire and negotiations are under way for a new agreement, the Chairman deems it best to leave this discipline entirely to the discretion of the union.

Nevertheless the arbitrator warned that he would:

> impose proper penalties on every worker who takes part in a stoppage and he will approve the discharge of any shop chairman or other individual who causes a stoppage. Shop chairmen who fail to exert any effort to keep

> their people at work pending the adjustment of grievances will be deemed to have encouraged the stoppage and will therefore be subject to removal.

This case illustrates the flexibility of the system of adjustment presided over by the then Chairman.

In Cases 186 and 187 two basters stopped work, claiming that the foreman had "indirectly discharged" them by trying to impose unjust conditions after the workers had taken an afternoon's vacation. The rest of the shop followed, and complaint was lodged against four individuals for actively instigating the walkout. The arbitrator's decision was:

> In regard to the two collar edge basters, the Chairman cannot recognize such a thing as an indirect discharge. Either the men refused to work or they were discharged. If the employer tried to impose unjust conditions on these men it was their business to continue work and file a complaint with their union and with the Impartial Chairman to have the unjust condition removed. Since they had no faith in the ability of the Union and the Impartial Chairman to redress their grievances, and instead chose to use direct action and quitting their jobs, they cannot expect the Chairman to reinstate them.

As for the rest of the shop, those workers who walked out blindly were thought to have received sufficient punishment in wages lost during the time they were out. The four men charged with special activity were treated as special cases. After examining the evidence, three of them were shown to have been active in instigating the stoppage and were discharged.

> This punishment may seem too severe, but information has come to the chairman that certain people in the shop have expressed the intention to have another walkout if the decision in this case is not to their liking. Under such circumstances there is no choice except to discharge these three men.

In Case 244 a stoppage occurred in a contractor's shop, but the employer refused to take the workers back when the union ordered them back to work. The arbitrator refused to hear the case until the employer reinstated the workers. Thereupon the employer filed a complaint against all who participated in the stoppage and particularly against two alleged instigators whom he wanted to discharge.

Two paragraphs of the arbitrator's ruling deserve quotation in full:

> It is admitted by both parties that the stoppage was a violation of the agreement meriting punishment. But the employer claimed the right to consider that all who took part in it had quit their jobs and he could rehire them or not as he pleased, while the union contended that the employer had no right to punish them in this manner for that would in effect be a lockout which is not justified as a reprisal for a stoppage. The Chairman is

> of the opinion that when people take part in a stoppage they cannot claim a right to their jobs under all circumstances. They may or may not be reinstated depending on the facts in the case as found by the Chairman or by mutual agreement between the employer and the Union.
>
> A stoppage cannot be considered mere quitting of work for that involves no violation of the agreement. The employer therefore has no right to assume that the people have quit and to rehire some while others are left out.[41] He may, however, discharge them all for taking part in the stoppage and in that case the Union would have the right to request reinstatement on the ground that the discharge was unjustifiable exactly the same as in the case of an individual discharge. But it cannot be assumed that a stoppage automatically acts as a discharge, any more than it does as a voluntary quitting of work. A stoppage must be considered a violation of the agreement by the people who take part in it, and the union must in every case order the people back to work immediately. In all such cases the employer must reinstate the people and file a complaint if he cares to, unless he has notified them and the Union in advance that he wishes to discharge them all for taking part in the stoppage in which case the Union may appeal to the Chairman to reinstate the people.

Because the employer refused to take the workers back, the arbitrator was

> of the opinion that the employer as well as the people who took part in the stoppage have been guilty of violating the agreement. Had the employer taken them back, then he might have secured redress from the Chairman. As it is the people are punished by the time they have lost, and the employer has the loss of production for his violation.

The charges against the two alleged instigators were not backed by sufficient proof to warrant dismissal, but the arbitrator warned them that repetition of their conduct would justify discharge.[42]

In Cases 192 and 196 a dispute arose over standards of production for offpressers. The employer threatened dismissal if his demands were not granted; whereupon the pressers walked out.[43] This was the old way of bargaining. The arbitrator said:

> If either the employer or the men had followed the procedure provided by the agreement, the Chairman would penalize the one that was in the wrong and give redress to the other. Since they thought they could do better by taking the law into their own hands, the Chairman cannot help them now. The loss of time and loss of production should serve as a lesson for the future.

Similarly when a section stopped work because it did not like the firm's price offer, "a stoppage is not justified as a method of getting a proper price[44] any more than a lockout would be justified when the workers ask a price that the employer considers too high" (Case 294).[45] Hence the union was requested to impose a fine because the usual penalty

of making up lost time by working overtime at straight pay was impracticable in the busy season. In a number of stoppages for all manner of purposes, from getting better prices or preventing certain workers from getting jobs to forcing personal privileges (Case 501), the arbitrator applied the principle that the party desiring redress must come "into court with clean hands" (Cases 302–303). Penalties variously applied were: (1) workers ordered to make up lost time by working overtime at straight pay; (2) workers ordered to pay fines varying from 50c to $2 per worker; (3) workers suffered loss of wages for duration of stoppage; (4) discharge of workers involved; (5) shop chairman removed from office; and (6) workers involved, and union, censured by arbitrator. In the case of lockouts, the employer was penalized by denial of rights of redress, loss of production during stoppage or lockout, or censure by the arbitrator.

Three stoppage cases involving more complicated facts deserve special consideration. In Cases 749–751 intermittent stoppages occurred for obscure reasons, the most definite of which appeared to be the arbitrator's decision fixing a new standard of production for off-pressing. On the first day the whole shop walked out; on the second day the off-pressers stopped work, and they in turn were followed by the second basters. The firm refused to reinstate the basters, and when the off-pressers refused to accept this discrimination in favor of themselves, the firm refused to reinstate the pressers. The firm, having in effect discharged the basters and pressers, petitioned the arbitrator to impose some lesser penalty on the rest of the shop for walking out the first day. In this state of facts we find the following offenses: (1) stoppage of the pressers to coerce a more favorable decision from the arbitrator; (2) sympathetic strike by the basters in support of the pressers, (3) by the pressers against discharge of the basters, and (4) by the rest of the shop in support of the pressers.

The arbitrator's opinion was substantially:

> Such procedure as this of the firm's will not only fail to prevent stoppages but will unintentionally bring the agreement and the impartial machinery into contempt. The most serious offense was that of the offpressers, for they violated not only the agreement but a specific decision affecting themselves. For this the firm did not think best to impose discharge as a penalty but did try to impose it on the basters for the less serious offense of stoppage in violation of the agreement alone.

After penalizing three of the offenses on its own responsibility, the firm then asked a lesser penalty for the remainder of the shop.

> The whole series of events should make clear the impracticability of varying the methods of procedure in dealing with and preventing stoppages…The impartial machinery will be ineffective in such matters if it is used only when smaller penalties are desired by a firm but is excluded from the procedure when the extreme penalty of discharge is to be imposed. Still less can the Chairman be effective if a firm chooses to impose the extreme penalty for stoppage alone but not for stoppage plus disregard of the Chairman's decision. In this case the firm's actions, though not so intended, threaten to bring the machinery into contempt.

> Consequently the firm's method of securing penalties must be entirely discarded.

The arbitrator ordered reinstatement of pressers and basters, who were fined $2 apiece.

In Cases 798–804 a section of sleeve sewers was discharged by a firm after a stoppage due to a grievance and an altercation with the foreman and labor manager. The latter informed the union that he did not want to take the men back. Nevertheless the union brought the men back and tried to persuade the firm to reinstate them. This was refused, the firm stating that the workers were discharged for walking out in violation of the agreement. The firm then tried to hire new sleeve sewers through the union and by approaching individuals, but without success. Four days after the stoppage the firm filed a complaint "against action resulting in a boycott." Due to illness of various persons a hearing was not held until eight days after this complaint.[46] The union counter-charged unjust dismissal, though it admitted that the boycott was effective because the discharged sleeve sewers "merely by talking of their grievance" kept "other sleeve sewers from taking the job."[47]

The arbitrator ruled that the sleeve sewers had doubly violated the agreement in stopping work and in not taking their grievance to the adjustment board.

> Practice as well as specific decision of the Chairman (Case 244) has recognized that discharge might be imposed by an employer for such violations. But such procedure sooner or later was sure to lead to such a situation as in this case…Whether the stoppage was sufficient ground for discharge or not, the double violation requires such a reprimand as only a discharge will give. All these sleeve sewers are discharged and both the Union and the firm are to cooperate in carrying out this decision so that the incident shall be closed.

In this case we have the common form of direct action to prevent the formation of contracts which has troubled and divided the courts in picketing and strike cases. Yet there was no evidence of malicious, in the sense of intentional, injury. The sleeve sewers very naturally aired their grievances and the effect of this was a labor boycott. But who can say, from the facts as stated, whether the boycott was a matter of design or conspiracy or merely the incidental effect of normal human behavior? If it were proved that the union deliberately refused to send alternative workers to this firm unless the firm rescinded the discharges of the sleeve sewers, the employer might reasonably claim that the boycott was, in legal terminology, a conspiracy.

The third stoppage case involved both the sympathetic strike and the secondary labor and materials boycott. In addition it probably went to the "verge of the law" if not beyond, as the agreement was then understood, because it involved interference with the exclusive province of management to solicit and carry out commodity contracts.

In Cases 327–335 the cutters stopped work, claiming that the firm was doing strike work from New York, where a lockout and strike involving members of the Amalgamated was being carried on. The arbitrator ordered the cutters to return to work pending investigation, because "a stoppage is not justified merely because the workers think such work is being done." The employers, speaking through legal counsel, raised

the question whether the Impartial Chairman had jurisdiction over the union's complaint.[48] This question was answered affirmatively by the arbitrator.

> The underlying principle of the agreement is that any grievance of the workers will be heard and decided in accordance with the rules laid down in the agreement, and only the Impartial Chairman has authority to decide whether a question is covered by the agreement or not. The agreement says that all disputes arising under the agreement shall be submitted to arbitration and there is no doubt that a stoppage because the workers think they are asked to work on goods for a house where there is a lockout or a strike is a dispute arising under the agreement. The Chairman is therefore of the opinion that it is his duty to determine the fact whether the work in question is really of this character and the agreement gives him authority to make decisions in all such cases.[49]

Having taken jurisdiction of the dispute, even though it involved the selling policy of a firm, the arbitrator faced two questions: (1) What does the agreement require if this was "strike work"? (2) Was the work in question "strike work"?

On the first question the arbitrator held:

> It can not be assumed, that when this union signed the agreement it entered into any arrangement which would compel its members to work for its own destruction. When employers in this or in other cities are engaged in a fight with the union, the members of the union can not be expected to do the work for those employers with whom the union is fighting and so help to destroy their own national organization which is a party to the agreement in Rochester. The member of the Clothiers' Exchange were well aware of this when the present agreement was entered into, and it must be held that the agreement reserves the right to members of the union not to work on any so-called "strike work."[50]

On the second question both sides submitted their evidence and the Chairman himself made an investigation of the facts. The employers presented evidence

> to show that it is a bona fide retail order for a retail chain of stores which has always bought goods in Rochester and in other markets besides getting a good deal from the New York manufacturer who has an interest in these stores. The Exchange contends that its members make goods for retailers and as long as this order is from a retailer for goods to be sold in the stores and not for the manufacturer whose people are locked out or on a strike, this can not be considered "strike work."

The union contended

> that the chain of retail stores is operated merely as a department of a manufacturing firm in New York which has locked out members of the

> Amalgamated from its shops and which, it is charged, has openly stated that its purpose is to destroy the union…and that goods and patterns were shipped up by this house

to the Rochester firm.

The arbitrator's investigation[51] disclosed

> that piece goods were sent up by the retail stores which evidently came from the New York manufacturer…No patterns were sent in this way, but a coat or two were sent up as models for the order…The chain of retail stores is a separate corporation with different officers and directors from the New York manufacturing firm but this firm does have a financial interest in the corporation.

The arbitrator therefore ruled:

> In view of these facts the employer had justification for assuming that he was taking a bona fide order from a retailer. On the other hand the fact that the retailer received piece goods from the New York manufacturing house which has an interest in the retail stores and which has offices in the same building with the offices of the retail corporation raises the suspicion that some of the finished goods might be turned over to the same manufacturer; and if that happened the union members would have a right to refuse to do this work. In order to avoid any difficulty in this regard and the strikes and stoppages which might result from it, the Chairman is of the opinion that the workers should finish out whatever work has already been cut, provided the rest is sent back and they are required to do no more of it.[52]

In other words, if A (a manufacturer) is engaged in a dispute with B (a union), the members of B, wherever located, are justified in refusing to work for C (an employer operating under an agreement with B) on goods destined for D (a retailer having financial relations with A), in order to coerce A to conform to the demands of B. Moreover this refusal of B to work for C is justified in the absence of an overt act showing that A will benefit directly from the contract between C and D. The justification rests on the broad ground of the common interest of all members of B, by whomever employed, in the struggle between A and the New York members of B.[53] The action of the Rochester members of B was a sympathetic strike against C in order to break a contract between C and D which might in the future have directly benefited A. If A had no financial interest in D, the situation would clearly have been that of a secondary boycott, which was, in effect, the argument of C. In view of the financial relationship, the situation was practically that of a primary boycott. If this financial connection between D and A were absent or overlooked, the union would have accomplished by means of the agreement and the adjustment machinery in Rochester what the United States Supreme Court declared illegal in the Duplex case.[54]

(c) Lay-off and permanent reduction of force

The above cases illustrate the tendency under the Rochester agreement to establish for the worker certain vested rights in his job. These rights were protected by the arbitrator against unjustified invasions by immediate or possible employers, by employers or workers outside the agreement, and by fellow workers. The object was to promote efficiency and orderly adjustment of disputes by making the worker feel that his job was secure and his future expectations reasonably certain.[55] The agreement was in no sense, however, a guarantee of continuous employment. Irregular employment was a risk, proceeding from fluctuations in commodity markets, which affected not only the tenure of the job, but also the certainty of earnings on the job; yet the agreement contemplated only the prevention of discrimination, favoritism and unequal treatment in the adjustment of vested job-rights to this risk.

The cases in which these situations arose group themselves under the two headings of lay-off and permanent reduction of force. The agreement (Sec. 7) specified that during slack times work should be divided equally among all workers "as far as practicable."[56] In some instances workers demanded a particular method of dividing the work, but the arbitrator held that the employer was privileged to arrange the division to suit his production requirements so long as each worker received an equal share (Case 288). But the employer could not divert work from one individual to another (Cases 295 and 623). Yet if one worker lost half a day more than the others on his operation, he had no complaint.

> As the agreement provides for equal division of work "so far as practic able" the slight difference in the case of this man comes within the differences arising from considerations of practicability [Case 723].

Moreover the union could not invoke the equal division of work principle during busy seasons against the reduction of an overmanned section, for that would lead to a permanent over-supply of labor (Case 385).

In some instances particular employers guaranteed their employees against a lay-off[57] and disputes arose concerning the application of these special agreements. In one case (51) such an agreement was claimed by the workers as justifying payment for time lost. The arbitrator could find no certain evidence of the existence or terms of such an agreement, but required the employer to pay for time lost because he laid off the whole shop to avoid paying for the idle time. In another case a verbal agreement to pay for idle time was proved to exist (Case 55). The workers claimed this required paying for idle time when laid off through no fault of their own;[58] the employer claimed that such payment was due only when the lay-off was the fault of employer. In this instance, the absence of five out of eighteen buttonhole makers caused the lay-off of the other workers. The arbitrator ruled that since neither party anticipated situations like this, the verbal agreement should not hold. But "it is the responsibility of management to keep a regular flow of work going through the shop and absences constitute one of the difficulties that management must calculate in advance on overcoming." However, the Chairman expressed the belief that as a matter of managerial policy, the workers should be paid for time lost because the verbal agreement was made to reassure employees that they would

not be working themselves out of jobs by increasing or maintaining production early in the season, and because it was desirable to avoid giving them this impression.[59]

But there is a vast difference between temporary separation from the opportunity to work and a permanent separation, such as occurs in permanent reductions of force. When only one section is involved, the difficulties in finding other jobs with the same or other firms are not so great. But when the entire shop is abandoned because it is unprofitable the difficulties are much greater. Two decisions will illustrate how these situations were dealt with.

In Case 594 ten cutters were given a week's notice of discharge on account of permanent reduction of force. The arbitrator held that, instead of immediate discharge, work should be divided until the union found jobs for the surplus cutters, who were to be the first source of supply to the union. In Case 698 a firm's announcement that one of its shops would be closed indefinitely was charged with being a violation of the spirit and letter of the agreement. The arbitrator ruled:

> The issues in this case are not covered by the letter of the agreement but by the unwritten understandings and established practices of the market. These have recognized employers' rights to a permanent reduction of force, to close down a shop and to enlarge a shop;[60] and the employees' rights to preference in employment by firms for which they have worked…except as limited by the permanent reduction of force …These preferential rights apply primarily to the same or similar operations as those performed in the old shop, and a former employee in Shop No. 3 is to be in no sense a new employee or on probation in the rest of the plant when given a position at his former operation. If an employee is offered and accepts a position on an entirely new operation, he may be treated as on probation on the new work. If he fails to make good he by no means loses his preferential rights to a position on this original operation when open.[61]

(d) Introduction of machinery

The tenure of the job was threatened, of course, by every change in managerial policy, but changed methods of manufacturing constituted the most serious threat of all. The introduction of machinery tended not only to displace the worker from a particular job but also to destroy the skill, acquired through long experience, which was the chief asset of the worker claiming a favorable differential in wages.

The agreement specified in Section 5:

> The right of the employer to make changes in shop management and methods of manufacturing is recognized, such changes to be made without loss to the employees directly affected.

In the situations that arose, the difficulty was to protect this right of the progressive employer while at the same time protecting the worker's skill and job. Two cases only

need be cited to show how the arbitrator construed the phrase "without loss to the employees directly affected."

In Case 346 an employer introduced new machinery which split the offpressing operation into several parts. Hitherto off-pressing had been done entirely by hand and was considered the most skilled of the pressing operations. The union complained that the machines were improperly introduced and that the change should not have been made because the off-pressers' skill was thereby taken away. The employer's argument against the union's first complaint was that the shop was new and all the pressers could not be called to work at once, and that all the pressers and the shop chairman knew the machines were in the shop and were openly told of the proposed change in work. Evidence showed that the pressers worked from three to six weeks without complaint, so that, while the matter was not tactfully handled by the employer, the shop chairman knew of the new methods and therefore could not complain of improper inducement.

The arbitrator ruled that there could be no dispute as to the right of the manufacturer to introduce new machinery provided the workers did not suffer thereby, saying:

> There is a certain amount of loss of skill from this splitting of the operation but that is inevitable and in place of it the worker gains the efficiency that comes from specialization.

Furthermore other operations in the market had been divided, and the pressers in this house were not entitled to special consideration or a favored position in the market.

The skill of the worker may be taken away in the interest of industrial progress. But an employer may not invoke the right to change manufacturing policies as a cloak for the arbitrary displacement of workers from jobs (Case 306); he should maintain earnings and keep the worker on the job until another place can be found for him by the employer or the union.

RELATION OF THE LAW TO EXTRA-JUDICIAL PROCESS

Flexibility was the outstanding characteristic of the system of "industrial jurisprudence"[62] worked out in the Rochester clothing market. The terms of the trade agreement were adapted by both parties and the arbitrator to the circumstances of each case. There were no rigid rules regarding admissibility of evidence or the weight to be attached to particular facts. Any relevant facts could be introduced by either party and the arbitrator could ask for or seek additional facts on his own initiative.[63] Procedure was informal; the jurisdiction of the arbitrator was broad; he was in close daily contact with the technical problems involved and with the persons charged with administering the agreement. The interplay of personalities—the psychological element which is so important a part of employer—employee relations—in short, the "industrial politics"[64] of the market could thus be taken into account in finding a workable solution of disputes. Finally, one may

note the adaptability of the sanctions at the arbitrator's disposal[65] to the practical requirements of each situation.[66] Although certain remedies came to be applied to certain types of wrongs, there were no hard and fast rules governing the use of penalties.

Nevertheless, flexibility of "substantive rights" or remedies would not accomplish the underlying purpose of stabilizing labor relations in the market if the common rules established by mutual agreement or by decision of the arbitrator were not rooted in the customs and usages of the parties themselves. These customs and usages grew up in the day-to-day bargaining over the terms and conditions of the morrow's jobs. Some of the customs were of recent origin, some of long standing, and some, indeed, were claimed merely as talking points for a more obscure aim not easily found without probing beneath the surface. Both employers and workers acted according to these customs and usages. When they clashed, as they often did, it was the arbitrator's task, if mutual adjustment failed, to explore the technological, business, political, and other factors in the dispute. Bearing in mind the desirability, from the standpoint of efficiency, of keeping the bargaining process going, he might approve the customs of the employer or of the workers, or might find a middle ground which would prove acceptable to both sides. Conformity to the common rules of the market was obtained by the moral sanction of threatening offenders with the ill-will of fellow workers or fellow employers, or by the economic sanction of withholding the privileges of the job or of the continued service of employees. This is a task requiring intimate knowledge of the industry and of the psychology of employers and employees.

This process of extra-legal or extra-judicial adjustment of employer-employee relations rests on a fundamental difference between commodity-transactions and job-transactions. In the job-transaction the worker delivers something that is inseparable from the body and will of the worker; in a commodity-transaction there is an exchange of things separable from the person. This distinction was implicit in the administration of the Rochester agreement. It raises two questions, (1) Are the courts of law—indeed is our whole legal system—equipped for the task of working out and enforcing the customs and common rules necessary to achieve that degree of stabilization of the labor market which will contribute most to economic efficiency and welfare? (2) Should not the courts allow to extra-judicial adjustment of labor relations at least the same freedom from legal consequences that is increasingly allowed in the arbitration of commercial relations?

NOTES

1 "…it is said by the Kansas Supreme Court (87 Kansas, p. 759) to be a matter of common knowledge that 'employees, as a rule, are not financially able to be as independent in making contracts for the sale of their labor as are employers in making contracts of purchase thereof.' No doubt, wherever the right of private property exists, there must and will be *inequalities of fortune;* and thus it naturally happens that parties negotiating about a contract are not equally unhampered by circumstances. This applies to all contracts, and not merely to that between employer and employee. Indeed, a little reflection will show that wherever the right of private property and the right of free contract co-exist, each party, when contracting, is inevitably more or less influenced by the question whether he has much property, or little, or none; for the contract is made to the very end that each may gain something that he needs or desires

more urgently than that which he proposes to give in exchange. And, since it is self-evident that, unless all things are held in common, some persons must have more property than others, it is from the nature of things impossible to uphold freedom of contract and the right of private property without at the same time recognizing as legitimate those inequalities of fortune that are the necessary result of the exercise of those rights." Coppage *v.* Kansas, 236 U. S. 1, 17, 35 Sup. Ct. 240, 244 (1915).

2 See State *v.* Coppage, 87 Kan. 752, 755–6, 125 Pac. 8, 9 (1912).

3 1 Williston, *Contracts* (1920) §§1, 2; 2 *ibid.* c. 30; Anson, *Contracts* (Huffcut ed. 1903) §§4, 6, 7, 9.

4 *Agreement for 1920–1922,* Sec. 9: "The board (Labor Adjustment Board) shall have authority to make such rules, regulations, and supplementary arrangements not inconsistent with this agreement as may be necessary to carry into effect the principles of this agreement or to apply these principles to new situations whenever they arise. It may also define, describe and limit the penalties to be imposed for the violation of any of the provisions of this agreement."
Sec. 8: "…All disputes or differences over questions arising under this agreement which the parties hereto are unable to adjust between themselves shall be referred to the Labor Adjustment Board for adjustment or arbitration. This board shall have full and final jurisdiction over all such questions, and its decisions shall be conclusive, except as may be otherwise provided by agreement between the parties hereto. Except where the board itself shall otherwise determine, the chairman of the board shall be authorized to take original jurisdiction of all cases and controversies arising under this agreement and to adjust or decide them in accordance with rules of practice and procedure established by the board. Decisions of the chairman shall be binding on both parties…"

5 *Agreement for 1922–1925,* §11: "…The duties and jurisdiction of the arbitrator are fixed and limited by this agreement. He shall have no power to enlarge such jurisdiction unless by mutual consent of the two parties to this agreement…."

6 A strike in 1913, involving members of the United Garment Workers, was settled partly through mediation by state officials. The terms of settlement included dealing with committees of employees, but not recognition of, or dealings with, the union. Winslow, "Collective Agreements in the Men's Clothing Industry," *Bulletin* 198, U. S. Bureau of Labor Statistics (1916) 144–149.
Labor difficulties with two firms in 1918 led to the Ripley-Kirstein award. The adjustment machinery established to work out this award prepared the way for negotiating the agreement in 1919 without a strike. For one account of the Ripley-Kirstein award, see *Report of General Executive Board of Amalgamated Clothing Workers to Fourth Biennial Convention, Boston, 1920,* 39–43.

7 Agreements were negotiated on behalf of the members of the local unions by the Joint Board, usually acting with the advice and assistance of the national president of the union. Under Art. XIV, §14, of the Constitution of the Amalgamated Clothing Workers, "All acts of the Executive Board (i.e. of the local union, or the Joint Board of the locals in a district) shall be subject to the ratification of the organization." By the same clause of the constitution, "in cases where a boycott is considered necessary by the local Executive Board the matter shall be submitted to the General Executive Board, or the General Convention, for approval and action." By Art. XI, §1, strikes had to be submitted to the General Executive Board of the Union for endorsement.
These provisions of the Union's constitution are cited because one of the questions raised in juridical consideration of a collective agreement, such as a contract, is the extent of the power of union officials to bind members. The power of union officials to act as agents in the formation of trade agreements or otherwise, so as to bind the union membership and possible outsiders, depends upon the general laws of agency. For a statement of the agency doctrine as to union officers, see Wrightington, *Unincorporated Associations and Business Trusts* (2d ed.

1923) §67; Grinnel, "Analysis of Legal Value of a Labor Union Contract" (1907) 41 *Am. L. Rev.* 197, 206; 24 Cyc. 824; 16 R. C. L. 425; Sayre, *Cases on Labor Law* (1922) c. 13. See also the following cases which illustrate the application of the agency doctrine to disputes involving construction of collective agreements. Barnes & Co. *v.* Berry, 169 Fed. 225 (C. C. A. 6th, 1909) (power of officials to negotiate binding agreement must be expressly authorized); Burnetta *v.* Marceline Coal Co., 180 Mo. 241, 79 S. W. 136 (1904); Hudson *v.* Cincinnati, New Orleans & Texas Pacific Railway Co., 152 Ky. 711, 154 S. W. 47 (1913) (officials may not bind individual members without their express assent); Langmade *v.* Olean Brewing Co., 137 App. Div. 355, 121 N. Y. Supp. 388 (4th Dept. 1910) (the specific provisions of individual employment contracts override conflicting provisions of the collective agreement); Saulsberry *v.* Coopers' International Union, 147 Ky. 170, 143 S. W. 1018 (1912) (union alone empowered to make agreements regarding the use of the union label).

8 A written version of this understanding may be found in the *Report of the General Executive Board of the Amalgamated Clothing Workers, op. cit. supra* note 6, at 45–46.

9 The full text of the written agreement may be found in (1920) 11 *Monthly Labor Rev.* 1220–1221.

10 Omitting supplementary agreements regarding notice of discharge or quitting *(infra),* the individual contracts of employment made under this clause were so-called contracts at will. More specifically, the legal relations of employers and employees, as individuals, were embodied in a series of unilateral contracts to pay for work done. In New York the rule, with a few exceptions, is that a contract of service for no stipulated time is a hiring at will which creates no legal obligations on either party to continue the relations in the future, that is, creates no mutual executory obligations. In Rochester this rule might be varied because of the clear, though unwritten, understanding that a week's notice should be given before discharge or quitting. 2 Williston, *op. cit. supra* note 3, §1027. The courts are divided on the question whether, in the absence of an express stipulation, a term may be presumed from the weekly payment of wages. 1 Williston, *op. cit. supra* note 3, §39; 39 C. J. §18. Whether a term may be presumed by reason of the duration of the collective agreement was discussed in Hudson *v.* Cincinnati Ry., *supra* note 7, the court holding that the collective agreement did not bind members to serve for any definite period.

11 Compare the arbitral treatment of alleged blacklisting with the legal treatment in Boyer *v.* Western Union Telegraph Co., 124 Fed. 246 (E. D. Mo. 1903) (employer's blacklist of union men not remediable in equity); Goldfield Consolidated Mines Co. *v.* Goldfield Miners' Union No. 220, 159 Fed. 500 (D. Nev. 1908) (agreement among mine operators not to employ members of the union held not to be an unlawful conspiracy; a statute similar to that involved in Coppage *v.* Kansas, *supra* note 1, being declared unconstitutional); Willner *v.* Silverman 109 Md. 341, 71 Atl. 962 (1909) (blacklist which prevented plaintiff from securing employment held an actionable wrong for which plaintiff might sue for damages).

11a These cases are reported in mimeograph form by the Rochester arbitrator chiefly for the information and guidance of the parties to the agreement in the local market. Cases are numbered as complaints are filed with the arbitrator and these docket numbers have been used throughout the article. The writer prepared a digest (unpublished) of the written opinions of the arbitrator during the first three years of the collective agreement. Occasionally significant opinions of the arbitrator are currently noted in the *Monthly Labor Review,* of the United States Department of Labor.

12 The Clothiers' Exchange established a central clearing house for listing the employees of each firm. Notices of accessions to, and separations from, the payroll of each firm were sent to the Exchange. Prior to hiring any individual worker, the custom was for an employer to telephone the Exchange and obtain a "release" on the worker from the previous employer. In this manner a check was kept on the worker's conformity to the week's notice rule. Since the

arrangement was instituted in a time of labor shortage, it also served in a measure to protect employers from the temptation to "steal labor" by raising wages. When shops started up after the "between-season" slump, the clearing house system was of some assistance to employers needing new workers. Furthermore, it afforded to the arbitrator a check upon the bare facts of employment, which were sometimes disputed in cases involving discharges during the probationary period and quitting without notice. In hiring, no questions were asked regarding union affiliations. Compare Street *v.* Shipowners' Association of Pacific Coast, 263 U. S. 334, 44 Sup. Ct. 119 (1923); Anderson *v.* Shipowners' Association of Pacific Coast, 272 U. S. 359, 47 Sup. Ct. 125 (1926) (in which the operations of an employers' association registration bureau were declared within the scope of the Sherman Act); Industrial Association of San Francisco *v.* United States, 268, U. S. 64, 45 Sup. Ct. 403 (1925), *rev'g* 293 Fed. 925 (N. D. Cal. 1923) (in which use of "permit system" controlling access to materials for the purpose of effecting the "open shop" in the local building industry, was held not to interfere with interstate commerce); Tilbury *v.* Oregon Stevedoring Co., 7 F. (2d) 1 (C. C. A. 9th, 1925) (in which an employers' registration system, which prevented plaintiff from obtaining employment, was held not to be an obstruction of interstate commerce).

13 The situation was similar to that in Willner *v.* Silverman, *supra* note 11. Compare with State *v.* Justus, 85 Minn. 279, 88 N. W. 759 (1902), sustaining an anti-blacklisting statute. As to the efficacy of such statutes, see Commons and Andrews, *Principles of Labor Legislation* (3rd ed. 1927) 123–125.

14 In Carnellier *v.* Haverhill Shoe Manufacturers' Association, 221 Mass. 554, 109 N. E. 643 (1915), a blacklist was declared illegal and likened to a boycott, Worthington *v,* Waring, 157 Mass. 421, 32 N. E. 744 (1892), being overruled.

15 Probably an injurious false statement regarding discharge is actionable even in the absence of statutes. Willner *v.* Silverman, *supra* note 11. A statute was involved in Hundley *v.* Louisville & Nashville Railroad Co., 105 Ky. 162, 48 S. W. 429 (1898), in which a false statement of the reason for discharge was held actionable. The Missouri Service Letter Act, which required corporations doing business in the state to give discharged or quitting employees, upon request, a letter stating the work performed and cause of separation, was upheld in Prudential Insurance Co. *v.* Cheek, 259 U. S. 530, 42 Sup. Ct. 516 (1922).

16 In the absence of other faults, a preferential shop agreement is clearly lawful. Underwood *v.* Texas & P. R. Co., 178 S. W. 38 (Tex. Civ. App. 1915). A preferential shop agreement was involved in Schlesinger *v.* Quinto, 201 App. Div. 487, 194 N. Y. Supp. 401 (1st Dept. 1922), in which the union obtained an injunction restraining an employer's breech of the collective agreement.

17 Where an agreement allows an employer to hire in the open market if the union is unable to furnish workers (a common form of agreement), an employer will not be enjoined from exercising this option. Goyette *v.* Watson Co., 245 Mass. 577, 140 N. E. 285 (1923). But the result is practically a closed shop, for the union usually tries to organize such non-unionists as rapidly as possible, and non-unionists are induced to join through hope of getting better terms of employment, by limiting competition for jobs, and by union protection of the job, or through fear of losing their jobs. Not infrequently a trade agreement specifically requires the employer to dismiss new employees who do not join the union within a stated time. A strike to enforce such a provision was declared lawful in Greenfield *v.* Central Labor Council, 104 Or. 236, 192 Pac. 783 (1920). But such an agreement has been held void as in restraint of trade, and therefore no defense to the union officials, in a suit for damages by a worker who was discharged at the instigation of union officials because he did not join the union within the time limit. Curran *v.* Galen, 152 N. Y. 33, 46 N. E. 297 (1897); Berry *v.* Donovan, 188 Mass. 353, 74 N. E. 603 (1905).

18 In Barzilay & Harris *v.* Loewenthal, 134 App. Div. 502, 119 N. Y. Supp. 612 (1st Dept. 1909), the Appellate Division of the New York Supreme Court reversed an order that the

union furnish workers, not otherwise employed, according to a clause of the agreement, because among several reasons, "no one but the employer's association can enforce the agreement and it is doubtful whether it can be enforced by injunction at all."

19 In Shinsky *v.* Tracey, 226 Mass. 21, 114 N. E. 957 (1917), a union agent was held liable in damages to a worker who was discharged from his job after being expelled from the union for joining a rival union. An injunction was also issued, and the collective agreement was held to be no defense. The court likened the action of the union to a boycott, adding, "the right to acquire property by labor is co-equal with the right to acquire property by contract." To the same effect, see Connors *v.* Connolly, 86 Conn. 641, 86 Atl. 600 (1913); Berry *v.* Donovan, *supra* note 17. But the same worker, being unable to secure employment, was denied a remedy against union officials because the refusal of employment by the employer was in support of a valid trade agreement and the acts of union officials were not malicious. Shinsky *v.* O'Neil, 232 Mass. 99, 121 N. E. 790 (1919); Hoban *v.* Dempsey, 217 Mass. 166, 104 N. E. 717 (1914). An employer was not enjoined from refusing to employ non-union workers as required by a closed shop agreement in Mills *v.* United States Printing Co., 99 App. Div. 605, 91 N. Y. Supp. 185 (2d Dept. 1904), and Kissam *v.* United States Printing Co., 199 N. Y. 76, 92 N. E. 214 (1910).

20 In Ryan *v.* Hayes, 243 Mass. 168, 137 N. E. 344 (1922), an inexperienced worker was hired on condition that he join the union. After joining, the union required that he take his turn with other members seeking jobs. He was denied damages and an injunction for an alleged conspiracy on the part of the union to prevent him from obtaining and holding his job.

21 In Smith *v.* Bowen, 232 Mass. 106, 121 N. E. 814 (1919), a strike to prevent continued employment of a non-union worker, formerly foreman in a shop in another city, when competent union workers were unemployed, was held unjustifiable in the absence of a closed shop clause in the agreement.

22 Coppage *v.* Kansas, *supra* note 1; Adair *v.* U. S., 208 U. S. 161, 28 Sup. Ct. 277 (1908); People *v.* Marcus, 185 N. Y. 257, 77 N. E. 1073 (1906).

23 In Case 555 a girl was discharged for repeated tardiness and quarrelling with other workers. The union claimed discrimination on account of union membership, but since no evidence supporting this claim was submitted, the discharge was upheld.

24 The legal treatment of interference with employment by third parties is unsettled and unsatisfactory, despite the decision of the majority of the United States Supreme Court in Hitchman Coal & Coke Co. *v.* Mitchell, 245 U. S. 229, 38 Sup. Ct. 65 (1917). The complexity of modern economic relations, the widening of markets and of competitive influences, and the rapidly changing customs of associated activity, are some of the factors that have made it difficult for the courts to protect beneficial relations between individuals from interference by other individuals and groups. One source of difficulty seems to be that the courts often cling to the idea that competition in the "struggle for life" is still between individuals, whereas, as a matter of fact, individuals nowadays act chiefly as representatives of groups, backed by the power of the group.

In general, inducing a breach of contract is held to be actionable. Sayre, "Inducing Breach of Contract" (1923) 36 *Harv. L. Rev*. 633, 666. Inducing the termination of a contract as well is also generally actionable in the absence of justification. *Infra* note 37. The arbitration cases mentioned above are comparable to the cases in which inducing the non-formation of a contract is actionable if unlawful means be used, or if the motive is to injure others and not benefit the actor. Strikes, picketing, and boycotts, the common weapons of unions in forcing employers to meet their terms, are, of course, interference by third parties with the formation of individual contracts. The difficulty lies in the fact that such activities always injure others more or less, for they invade the employer's right of free access to labor and commodity markets, which right the courts have found it necessary to protect in order to preserve "free competition." Permissible interference with this right varies greatly in different states. Sayre

op. cit. supra note 7, c. 4–10.

The above arbitration cases, which tended to circumscribe the employer's right to hire whom he pleased and the out-of-town workers' right of access to employment opportunities in Rochester, involved only peaceable means, i.e., persuasion. Some courts, however, have enjoined even persuasion not to enter employment, because it interfered with an employer's right to unhindered access to the labor market. Sherry *v.* Perkins, 147 Mass. 212, 17 N. E. 307 (1888); Vegelahn *v.* Guntner, 167 Mass. 92, 44 N. E. 1077 (1896); Jersey City Printing Co. *v.* Cassidy, 63 N. J. Eq. 759, 53 Atl. 230 (1902); Frank & Dugan *v.* Herold, 63 N. J. Eq. 443, 52 Atl. 152 (1902); Brennan *v.* United Hatters, 73 N. J. L. 729, 65 Atl. 165 (1906). It is to be noted that these cases are not very recent. But in Carnes *v.* St Paul Union Stockyards Co., 164 Minn. 457, 205 N. W. 630 (1925), the court intimated that interference which prevented the formation of employment contracts might be unlawful unless justified by legitimate trade interests. In this case the means used were beyond doubt lawful persuasion; the earlier cases illustrate nicely how much at variance judicial and industrial concepts of reasonable persuasion and economic coercion often are. In this connection one may also observe that some courts, following the principle laid down in American Steel Foundries *v.* Tri-City Central Trades' Council, 257 U. S. 184, 42 Sup. Ct. 72 (1921), have so narrowed the privilege of picketing that the possibilities of inducing by persuasion either the termination or non-formation of contracts are remote indeed. Jefferson & Indiana Coal Co. *v.* Marks, 287 Pa. 171, 134 Atl. 430 (1926).

In New York, "assuming a justifiable motive (if that be necessary), it is not unlawful by persuasion, agreement, and entreaty, accompanied by picketing, patrolling or spying, to induce a breach of contract, or the termination or non-formation of contract." Huffcut, "Interference with Contracts and Business in New York" (1905) 18 *Harv. L. Rev.* 423, 431. But recent New York cases have held that peaceful picketing which prevents the formation of employment or commodity contracts may be enjoined. See Comment (1927) 36 *Yale Law Journal* 557. However, in Exchange Bakery and Restaurant *v.* Rifkin, 157 N. E. 130, 134 (N. Y. 1927), the New York Court of Appeals upheld the privilege of peaceful picketing, reversing the judgment of the Appellate Division, 216 App. Div. 663, 215 N. Y. Supp. 753 (1st Dept. 1926).

25 In Fairbanks *v.* McDonald, 219 Mass. 291, 106 N. E. 1000 (1914), the court approved an injunction and damages for interference with employment by rival unionists. The court said at 297: "In contemplation of law, they acted from malice towards the plaintiffs, and did to them an unlawful injury, by causing their exclusion from the labor market."

26 In New York closed shop agreements which amount to a local monopoly appear to be illegal, but agreements with some, but not all, similar shops in the locality, are valid. (1924) 2 *Wis. L. Rev*. 369. The courts generally seem to be about evenly divided when the closed shop policy involves a monopoly of an entire trade, making it difficult for a non-union worker to get a job. See Comment (1921) 30 *Yale Law Journal* 280, 285; Sayre, *op. cit. supra* note 24, c. 5; cf. Connors *v.* Connolly, *supra* note 19; Tracey *v.* Osborne, 226 Mass. 25, 114 N. E. 959 (1917).

27 As a matter of law, therefore, individual employment contracts during the two weeks' probationary period were, strictly speaking, hiring at will. 1 *Williston, op. cit. supra* note 3, §39.

28 Such limitations on discharge in collective agreements have not been controlling unless the individuals concerned expressly contracted in reference thereto. Hoey *v.* New Orleans & Great Northern Ry., 159 La. 258, 105 So. 310 (1925); Hudson *v.* Cincinnati Ry., *supra* note 7; cf. Caven *v.* Canadian Pacific Ry [1925] 1 D. L. R. 122; (1925) 38 *Harv. L. Rev.* 833.

29 The week's notice rule, being generally known, would probably be controlling in law also. 2 Williston *op. cit. supra* note 3, §1027.

30 As to what, in the law, constitutes a material breach of duty of servant to master, justifying discharge, see 2 Williston, *op. cit. supra* note 3, §§1013–1014, 1017–1018, 1020–1022; 1

Labatt, *Master and Servant* (2d ed. 1913) §§268, 273–274, 288–299; 39 C. J. §§79–90.

31 Compare 2 Williston, *op. cit. supra* note 3, §1014; 1 Labatt, *op. cit. supra* note 30, §§293–294, on the legal duty to render "diligent and skillful service."

32 In Hoey *v.* New Orleans Great Northern Railroad Co., *supra,* note 28, plaintiff had been discharged in violation of an agreement with his union. The Railroad Labor Board recommended reinstatement and defendant notified him to return to work, but plaintiff failed to return to work because of a strike involving his craft. The court held that the plaintiff was entitled to wages during the period of wrongful discharge until notified to return to work, the defendant by such notice having accepted the decision of the arbitration board. In Hudson *v.* Cincinnati, New Orleans & Texas Pac. Ry. Co., *supra* note 7, a trade agreement was held not to be a contract upon which the plaintiff could rely in an action for damages for wrongful discharge in violation of agreement, for the agreement was merely a memorandum of usages.

33 In the majority of jurisdictions a strike to compel the discharge of non-union employees is not *per se* illegal. Sayre, *op. cit. supra* note 24, at 311 n. and 318, n 1. Massachusetts and New Jersey are conspicuous examples of the opposite doctrine. Plant *v.* Woods, 176 Mass. 492, 57 N. E. 1011 (1900); Shinsky *v.* Tracey, *supra* note 19; State *v.* Donaldson, 32 N. J. L. 151 (1867). But see Jersey City Printing Co. *v.* Cassidy, *supra* note 24.

34 It is a well settled rule of law that courts will not interfere in the internal affairs of associations, where a remedy is provided by the association, until that remedy has been exhausted. Wrightington, *op. cit. supra* note 7, §57; Sayre, *op. cit. supra* note 4, c. 14; see Brennan *v.* United Hatters, *supra* note 24 (withdrawal of plaintiff's membership card held not warranted by the laws of the association and damages awarded for consequent discharge from job); Reihing *v.* Local No. 52, Brotherhood of Electric Workers, 94 N. J. L. 240, 109 Atl. 367 (1920) (withdrawal of temporary working card, after applicant failed to pass union's entrance examination, not actionable, even though plaintiff lost job and union had closed shop agreement with "greater number" of master electricians of that locality); Malone *v.* Brotherhood of Locomotive Firemen and Enginemen, 94 N. J. L. 347, 110 Atl. 696 (1920) (worker had right to sue for damages for interference with employment by union which procured his discharge and prevented reemployment, though the employee had not exhausted his remedies as provided in agreements with railroad administration); Mosshamer *v.* Wabash Ry. Co., 221 Mich. 407, 191 N. W. 210 (1922) (court refused to enjoin railway from putting into effect an order of the union which deprived plaintiff of seniority rights, since the order of the union was made according to the customs and by-laws of the association); Chambers *v.* Davis, 128 Miss. 613, 91 So. 346 (1922) (court refused to enjoin defendants from taking jobs of plaintiffs who were transferred from the regular to the extra list in accordance with union construction of seniority clauses in agreement with railway company, because it was not the "proper function of the courts" to arbitrate disputes between employees as to relative rights "under their contract with the company," there being a vigorous dissent on the ground that the agreement secured valuable rights which the courts should protect).

35 The ruling in this case was incorporated in the 1922–1925 agreement. Sec. 3: "The employer recognizes the obligation of workers who are members of the union, to pay their union dues."

36 This was the alternative adopted in Cases 151–154, *infra*.

37 Just what facts constitute legal justification for inducing the termination of a contract terminable at will, which would otherwise be actionable, is not clearly formulated in the cases. Sayre, *loc. cit. supra* note 24; *ibid. op. cit supra* note 24, c. 4, §2; Huffcut, *op. cit. supra* note 24. For cases which hold that a trade agreement is a good defense, see Hoban *v.* Dempsey, *supra* note 19; Tracey *v.* Osborne, *supra* note 26; Mills *v.* U. S. Printing Co.; Kissam *v.* U. S. Printing Co., both *supra* note 19; Scarano *v.* Lemlein, 66 Misc. 174, 121 N. Y. Supp. 351 (Sup. Ct. 1910); Cusumano *v.* Schlessinger, 90 Misc. 287, 152 N. Y. Supp. 1081 (1915); Maisel *v.* Sigman, 123 Misc. 714, 205 N. Y. Supp. 807 (Sup. Ct. 1924); Underwood *v.* Texas Pacific Railroad Co., 178 S. W. 38 (Tex. Civ. App. 1915); Uden *v.* Schaefer, 110 Wash. 391,

188 Pac. 395 (1920); Harmon *v.* United Mine Workers, 166 Ark. 255 (1924). *Contra:* Berry *v.* Donovan, *supra* note 17; Smith *v.* Bowen, *supra* note 21; Shinsky *v.* Tracey, *supra* note 19. Compare with Hitchman Coal & Coke Co. *v.* Mitchell, *supra* note 24; Callan *v.* Exposition Cotton Mills, 149 Ga. 119, 99 S. E. 300 (1919); Patterson Glass Co. *v.* Thomas, 41 Cal. App. 559, 183 Pac. 190 (1919).

The rule adopted in the leading English cases is that a union official is justified in interfering with advantageous relations between employers and employees when acting for union purposes. Allen *v.* Flood [1898] A. C. 1; South Wales Miners' Federation *v.* Glamorgan Coal. Co. [1905] A. C. 239; Sorrell *v.* Smith [1925] A. C. 700; cf. Conway *v.* Wade [1909] A. C. 506.

38 Unless Y conformed to union rules. Cf. Fairbanks *v.* McDonald, *supra* note 25; Connors *v.* Connolly, *supra* note 26.

39 The above situations were not unlike the common boycott. At the instigation of W (the union), A (the arbitrator) induced E (an employer) to withdraw or withhold patronage from C (a contractor) until C conformed to the sanitary standards and other rules established by the agreement. Insofar as W, E and A had a common interest and unanimity of opinion in acting against C, the situation was more like a primary boycott, which is perfectly legal. Mills *v.* U. S. Printing Co.; Kissam, *v.* U. S. Printing Co., both *supra* note 19; Pierce *v.* Stablemen's Union, 156 Cal. 70, 103 Pac. 324 (1909). But in most cases E would have continued business relations with C if A, at the instigation of W, had not interfered, and this situation is comparable with the secondary boycott, which is generally illegal except in three jurisdictions. Duplex Printing Press Co. *v.* Deering, 254 U. S. 443, 41 Sup. Ct. 172 (1921).

40 Fines were paid into a fund which, under the administration of the Labor Adjustment Board, was used for the relief of needy workers in the market. The question of liquidated damages versus penalty did not enter. For a case in which the union recovered liquidated damages awarded by an arbitration board for the employer's breach of the agreement see Maisel *v.* Sigman, *supra* note 37.

41 In Iron Molders' Union *v.* Allis-Chalmers Co., 166 Fed. 45, 52 (C. C. A. 7th, 1908), Judge Crosscup said: "A strike is cessation of work by employees in an effort to get for the employees more desirable terms. A lockout is cessation of the furnishing of work to employees in an effort to get for the employer more desirable terms. Neither strike nor lockout completely terminates, when this is its purpose, the relationship between the parties." Cf. Martin, *Modern Law of Trade Unions* (1910) §58 and cases cited.

42 Compare the situation in the above case with that in Mechanics Foundry & Machine Co. *v.* Lynch, 236 Mass. 504, 128 N. E. 877 (1920), where a strike to compel reinstatement of a discharged employee was declared illegal.

43 In Schlesinger *v.* Quinto, *supra* note 16, the union obtained an injunction against an employer's breach of an agreement which established the week work system in place of piece-work.

44 A stoppage to obtain higher wages than those stipulated in the agreement, as modified by an arbitration award, was involved in Nederlandsch Amerikaansche Stommvaart Maatschappij (Holland-American Line) *v.* Stevedores' & Longshoremen's Benevolent Society, 265 Fed. 397 (E. D. La. 1920). The employer recovered damages for breach of contract (collective agreement). The union, however, was incorporated. This decision illustrates one reason for the opposition of unions to incorporation and also for the fairly general feeling among unionists that trade agreements are, or should be, only morally binding, not enforceable at law. Originally many unions were inclined to favor incorporation, but this is no longer generally true. They fear that incorporation will make it easier for employers to get at union funds. Moreover the mere act of incorporation does not eliminate the difficulty experienced by union leaders in controlling the acts of individual members in trade disputes. The prevailing legal doctrine has been that unincorporated associations, like unions, may not be sued in the

common name in the absence of a statute authorizing such suits, although a different rule is frequently applied in equity. St Paul Typothetae *v.* St Paul Bookbinders' Union No. 37, 94 Minn. 351, 102 N. W. 725 (1905). That this doctrine may be discarded by the courts on their own motion is shown by the opinion of the United States Supreme Court in United Mine Workers *v.* Coronado Coal Co., 259 U. S. 344, 42 Sup. Ct. 570 (1922). The trend of legal opinion seems to be definitely in the direction of holding unincorporated unions suable in their common names. Under this doctrine service of process on the chief official of the union would be sufficient to "authorize judgment and execution against common property." Sturges, "Unincorporated Associations as Parties to Actions" (1924) 33 *Yale Law Journal* 383.

45 Compare the result achieved in Maisel *v.* Sigman, *supra* note 37, with that in Schwartz *v.* Wayne Circuit Judge, 217 Mich. 384, 186 N. W. 522 (1922), and Schwartz *v.* Cigar Makers' International Union, 219 Mich. 589, 189 N. W. 55 (1922).

46 This was an unusual delay in disposing of a complaint, except, of course, general wage adjustments. Compare procedural delays in the law as illustrated in injunction cases and damage suits. An extreme case is that of the United Mine Workers *v.* Coronado Coal Co., *supra* note 44, in which the original complaint was filed in September 1914 and all phases of the case are not yet finally litigated. Coronado Coal Co. *v.* United Mine Workers, 268 U. S. 295, 45 Sup. Ct. 551 (1925). The longest period between a temporary restraining order and a final injunction was six years in the Hitchman case.

47 Compare recent New York Supreme Court cases holding that peaceful picketing in the absence of a trade dispute is unlawful. See Comment (1927) 36 *Yale Law Journal* 557.

48 It will be recalled that under the Rochester agreement the decision of the arbitrator as to jurisdiction was final. *Supra* note 4.

49 The willingness of the arbitrator to assume jurisdiction over an apparently borderline case may be compared with the similar attitude of courts toward disputes arising under collective agreements. For example, compare the majority and dissenting opinions in Chambers *v.* Davis, *supra* note 34, and the opinion in Hudson *v.* Cincinnati Ry., *supra* note 7, with the opinions in Maisel *v.* Sigman, *supra* note 37, and Hoey *v.* New Orleans Ry., *supra* note 28. The trend of judicial opinion, particularly in New York, seems to be in the direction, on one ground or another, of construing trade agreements as contracts and consequently of giving remedies in disputes arising thereunder. See Clark, "Collective Bargaining in the United States of America" (1927) 15 *International Labour Rev.* 197; Clark, "Legal Effect of Collective Agreements" (1921) 12 *Monthly Labor Rev.* 416; Fuchs, "Collective Labor Agreements in American Law" (1925) 10 *St Louis L. Rev*. 1.

One may well surmise how the courts would have treated this assumption of jurisdiction by the arbitrator if, as a result of this award, either party to the agreement had sought to test its validity by legal action. The awards under the Rochester agreement fall within the classification of common law arbitration. If the collective agreement is construed as a contract and is also construed to cover such disputes as the one involved in Case 327 above, the common law doctrine is clear and of long lineage that such an award will be enforced barring other faults. 5 C. J. §§389, 555 *et seq.*

Illustrating the judicial treatment of arbitration awards in pursuance of a collective labor agreement are the following cases: Mastell *v.* Salo, 140 Ark. 408, 215 S. W. 583 (1919); Maisel *v.* Sigman, *supra* note 37, with which may be compared Gregg *v.* Starks, 188 Ky. 834, 224 S. W. 459 (1920); Chambers *v.* Davis, *supra* note 34; Malone *v.* Brotherhood of Locomotive Firemen & Enginemen, *supra* note 34; Hoey *v.* New Orleans R. R., *supra* note 28. In the Gregg and Malone cases the railway board of adjustment functioned under authority of the Director-General of Railroads, who, in turn, derived his authority from an Act of Congress. Presumably, therefore, the arbitration decisions in these cases were not awards in the common law sense.

50 The privilege of union members to refuse to work on "strike work" and to strike rather than do

so was upheld in Iron Molders' Union *v.* Allis-Chalmers Co., *supra* note 41. Cf. Pacific Typesetting Co. *v.* Typographical Union, 125 Wash. 273 (1923), in which the fact that plaintiff's work was not "strike work," in a strict sense, was a material point in the court's decision to award damages against the union.

51 Independent investigation by the arbitrator was a not uncommon method of getting at the relevant facts of a dispute. The methods of finding facts varied with the circumstances of the case. If the adequacy of a rate for a particular operation was disputed, the arbitrator might go into the shop and observe the operation himself; he might appoint an investigating committee composed of representatives of employers and workers not directly involved in the controversy; he might informally ask the opinion of foremen or production supervisors in other firms, or of union agents or shop chairmen who had worked or were working on the operation in question. In cases 327–335 the arbitrator happened to be a former arbitrator in the New York market and hence knew something of the surrounding circumstances. In any event the arbitrator was not obliged to rely solely on the facts brought in evidence by the parties to the immediate dispute as in the case in court proceedings.

In People *v.* Epstean, 102 Misc. 476, 170 N. Y. Supp. 68 (Ct. Gen. Sess. 1918), which involved the validity of a uniform price list for photo-engraving under the New York anti-trust statute, the judge, at the suggestion of the parties, visited a shop and watched the process of making a photo-engraving plate. He reached the conclusion that "photo-engraving is not a commodity," within the scope of the statute, but "is rather to be regarded as an art or process,…work, labor and services." It is at least a reasonable inference from the opinion that the judge came to this conclusion mainly as a result of his personal investigation. Compare Standard Engraving Co. *v.* Volz, 200 App. Div. 758, 193 N. Y. Supp. 831 (1st Dept. 1922), in which a strike to force employers to conform to a union rule establishing a minimum base price for photo-engraving was held to have been properly enjoined. In this case the opinion of the court dealt almost entirely with legal rules of statutory construction.

52 This decision, with others, led to the narrowing of the arbitrator's jurisdiction in the 1922–1925 agreement, *supra* note 5. The reason for this restriction appears to be that of protecting the arbitrator against having to make decisions on basic industrial policy for which the parties themselves should accept full and mutual responsibility. *Seventh Biennial Report of General Executive Board of Amalgamated Clothing Workers* (1926) 25–27.

53 Cf. Justice Holmes's dissenting opinion in Vegelahn *v.* Guntner, *supra* note 24, at 107.

54 Duplex Printing Press Co. *v.* Deering, *supra* note 39.

55 The same aim underlay the adjustment of disputes regarding earnings on the job, though the protection of earnings was more a matter of standardization, i. e., the application of the formula "equal pay for equal effort," with some adjustment of earnings levels to accomplish other purposes (such as equalization with other competing markets, standard of living, discouragement of home work). The wage cases are too numerous to summarize here. See Morehouse, "Development of Industrial Law in the Rochester Clothing Market" (1923) 37 *Quar. J. of Ec.* 257.

56 In Minasian *v.* Osborne, 210 Mass. 250, 96 N. E. 1036 (1911), a strike to abolish a system of helpers which resulted in unequal division of work during slack periods was not enjoined. In National Association of Window Glass Manufacturers *v.* U. S., 263 U. S. 403, 44 Sup. Ct. 148 (1923), an agreement to divide factories into two groups and operate each only during certain periods of the year did not constitute an unreasonable restraint of trade. In Benito Rovira Co. *v.* Yampolsky, 187 N. Y. Supp. 894 (Sup. Ct. 1921), the plaintiff laid off men and the defendant, representing a committee of the plaintiff's employees (no union was involved), told plaintiff that the workers would strike unless all were retained or work was divided equally. The court ruled that the strike was illegal and should be enjoined.

57 On the legal duty of the employer to furnish work, see 2 Williston, *op. cit. supra* note 3, §1015; 26 Cyc. 1017 and cases cited. Under a term contract there appears to be often an

implied legal duty to furnish work (or compensation) for the term of the contract, omitting such complications as impossibility of performance due to bankruptcy. Under a contract at will there is no such obligation. Where payment is by the piece, the law recognizes no such duty unless it is expressly stipulated, or the custom of the industry clearly requires the employer to furnish work or pay for idle time. Texas Central R. R. *v.* Newby, 41 S. W. 102 (Tex. Civ. App. 1897).

In Schwartz *v.* Wayne Circuit Judge, and Schwartz *v.* Cigar Makers' International Union, both *supra* note 45, the plaintiffs were cigar manufacturers who had been operating under a union agreement. The union agreed to a cut in wages in return for an agreement by the employers "to furnish employment to their shop capacity for a year" to members of the union only. Instead, the plaintiff hired some 200 non-unionists and when a strike ensued to enforce compliance with the agreement, the plaintiff asked for an injunction restraining picketing, interference, etc. The union filed a cross-bill asking an injunction restraining the breach of the agreement. The union's request was denied and an injunction granted to the employers. "In the instant case the practical effect of the decree (i.e., for the union) is to control the conduct of the business of the plaintiff…" Compare Blum & Co. *v.* Landau, 155 N. E. 154 (Ohio, 1926), in which an employee recovered wages due under an unemployment insurance clause of a collective agreement.

58 Compare Illinois Central R. R. *v.* Baker, 155 Ky. 512, 159 S. W. 1169 (1913), in which miners who had been laid off by a mining company on account of negligence of the railroad in failing to supply the company with cars (for which negligence the mining company obtained damages from the railroad) sought unsuccessfully to recover damages from the railroad for wages lost during lay-off.

59 In Moody *v.* Model Window Glass Co., 145 Ark. 197, 224 S. W. 436 (1920), the court upheld the employees' claim under a national agreement for wages while waiting for work. Cf. Mastell *v.* Salo, *supra* note 49 (worker recovered wages awarded by arbitration under agreement, though worker was uninformed as to his rights in the matter until agents of his union took up his case); Gulla *v.* Barton, 164 App. Div. 293, 149 N. Y. Supp. 952 (3d Dept. 1914) (worker recovered difference between wages paid by employer and wages due under agreement with union). See also Keysaw *v.* Dotterweich Brewing Co., 121 App. Div. 58, 105 N. Y. Supp. 562 (4th Dept. 1907).

60 The right or privilege of an employer to close down an unprofitable shop was involved in two recent cases. In Welinsky *v.* Hillman, 185 N. Y. Supp. 257 (Sup. Ct. 1920), the Amalgamated Clothing Workers had struck to compel an employer to continue the manufacturing department of his establishment, which he had determined to abandon. Plaintiff asked for an injunction restraining the strike. This was granted on the ground that the strike was unjustified "coercion in support of a demand which the employees had no right to make." The court said: "I am not insensible to the hardship to old employees thus suddenly thrown out of work, or of the loyalty of their fellow workers, who seek to come to their rescue; but I see no justification under the law for their present attempt, or the attempt of their union, to compel the plaintiff to continue their employment. Such situations may very well suggest doubts and problems to the student of social science; but in the present state of our law, which is adapted to prevailing conceptions of individual rights, I think there is no doubt about the decision which must be given here." A similar situation was involved in Maisel *v.* Sigman, *supra* note 37, in which the plaintiff resigned from the employer's association in order to reorganize his business, eliminating much of the "inside manufacturing" which was controlled by agreement between the union and the employer's association. After a strike, a new agreement was made, including arbitration and liquidated damage clauses and restrictions on the employer's tendency to contract out his work. For breach of this agreement and refusal to abide by an arbitration award, the union recovered liquidated damages.

In Rutan Co. *v.* Local No. 4, Hatters' Union of America, 97 N. J. Eq. 77, 128 Atl. 622 (1925),

the plaintiff found that his "making shop" was unprofitable and that he could purchase hats "in the rough" cheaper than he could make them. He therefore closed down the shop and discharged the workers. The employees in the finishing shop of the same firm struck in sympathy. Plaintiff asked for an injunction, claiming that the strike was for the purpose of forcing him to re-open the abandoned shop. The defendant union claimed that the strike was in pursuance of their own interests as expressed in a union by-law that no manufacturer should be given a union label who had a "making shop" and bought hats in the rough, unless the making shop was run to capacity. The opinion of the court is interesting. "…if… the purpose of a strike is, and as the complainant contends it is here, to compel an employer to run his shop against his will, and to his injury re-employ his discharged hands, for whom he has no use, then the strike is unlawful, for the union has no right to prevent employers of labor from profitably prosecuting their business." Yet the court found that the proof in this case did not show such unlawful purpose, although admitting that the plaintiff "may have to re-establish its plank shop, i.e., making shop, or go out of business altogether." "…for such misfortune the members of the union disclaim responsibility, and rightly. They were not under contract to work; they have done nothing more than refrain from working; they have not prevented the complainant from procuring others to take their places, and none of the usual strike tactics has been resorted to to deter others from taking their places, nor have they in any way interfered with the complainant in the carrying on of its business in its own way. In fine, their attitude has been simply one of hands off and let the complainant get along as best it may without them. This attitude is not open to judicial criticism."

61 As to seniority rights under a trade agreement after a layoff, see Mosshamer *v.* Wabash Ry. Co., *supra* note 34; Dickinson *v.* Brotherhood of Locomotive Firemen and Enginemen, unreported case, District court, 2nd Judicial District, Division 3, City and County of Denver, Colo. (1925).

62 Ernst, "The Development of Industrial Jurisprudence" (1921) 21 *Col. L. Rev*. 155.

63 A court of law relies, almost necessarily, on the facts brought out by counsel who are themselves playing the game according to rules of law. Even when the lawyers seek to bring pertinent industrial facts to the court's attention, it is often difficult to get them into the record. Rules of evidence and of pleading, interpreted by the court, are frequently insurmountable obstacles. Examine the history of Michaels *v.* Hillman, 111 Misc. 284, 181 N. Y. Supp. 165 (Sup. Ct. Sp. T. 1920); 112 Misc. 395, 183 N. Y. Supp. 195 (Sup. Ct. Tr. T. 1920).

64 As in Cases 151, 154 *supra*.

65 As in the stoppage cases, *supra*.

66 To a certain extent the law recognizes that both legal and equitable remedies can not be used satisfactorily by courts in all situations. The rise of equity courts as supplements to the common law courts is but one illustration. Even in equity, specific performance of personal service contracts has always been found impracticable, though recently there has been a tendency to secure enforcement indirectly by the use of injunctions. Pomeroy, *A Treatise on the Specific Performance of Contracts* (3d ed. 1926) §§22, 303–312. In this country attempts by legislatures to restrict the use of injunctions in labor disputes have been rebuffed. Truax *v.* Corrigan, 257 U. S. 312, 42 Sup. Ct. 124 (1921). In England, however, the Trades Disputes Act of 1906 eliminated both legal and equitable remedies in disputes between employers and employees and between workmen growing out of employment. However, in National Sailors' & Firemen's Union *v.* Reed [1926] 1 Ch. 536, Justice Astbury declared in a dictum that the general strike of May, 1920 was illegal, being outside the scope of the Act of 1906. Since the general strike, there has been much discussion of an amendment to the Act of 1906 so as to protect the consuming public more adequately. See Goodhart, "The Legality of the General Strike in England" (1927) 36 *Yale Law Journal* 464. Despite the desirability of American legislation similar to the Trades Disputes Act, it is doubtful whether such a statute would long survive judicial interpretations of constitutional law. In Massachusetts proposed legislation

made tortious acts in behalf of a trade union or employer's association non-actionable. An advisory opinion held the proposed statute unconstitutional. Opinion of the Justices, 211 Mass, 618, 98, N. E. 337 (1912).

67 Cohen, "The Law of Commercial Arbitration and the New York Statute" (1921) 31 *Yale Law Journal* 147; Ernst, *op. cit. supra* note 62; *Report of Committee on Commerce, Trade and Commercial Law to American Bar Association* (1925), especially recommendations No. 5, 6 and 7. In following the recommendations of the Bar Association committee—that arbitration awards under "contracts" between unions and employers' associations be enforced at law if the agreements are "in the public interest"—there is danger of re-introducing the inflexibility and impractical classification of labor contracts with commodity contracts which many arbitration agreements seek to avoid. It would therefore seem desirable to discuss and perhaps experiment with some such safeguards as the following: (1) No judicial interference until the remedies under the arbitration agreement have been exhausted; (2) Judicial acceptance of arbitrator's award as conclusive of the facts and also, as far as possible, conclusive of the law; (3) Remand the case to the arbitrator if, subsequent to his award, one of the parties seeks to introduce new evidence in an action at law. This procedure has been deemed necessary to make effective the work of such administrative bodies as the Federal Trade Commission and certain Public Utility Commissions—the Railroad Commission of Wisconsin, for example. Wis. Stat. 1923, c. 196, §44; (4) Designation of one court in each jurisdiction to hear all cases appealing from an arbitration award. Cf. Wis. Stat. 1923, c. 196, §41 in the case of the Railroad Commission. If we are to have judicial review of arbitration awards, it seems reasonable that the parties should have the benefit of judicial opinions that are founded on the familiarity with technical details which is most likely to result from specialization.

34
INSTITUTIONAL ECONOMICS

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An institution is defined as collective action in control, liberation and expansion of individual action. Its forms are unorganized custom and organized going concerns. The individual action is participation in bargaining, managing and rationing transactions, which are the ultimate units of economic activity. The control by custom or concerns consists in working rules which govern more or less what the individual can, must, or may do or not do. These are choices, resolved into performance, forbearance or avoidance while participating in transactions. The working rule of the Supreme Court is due process of law. The universal principles, that is, similarities of cause, effect, or purpose, discoverable in all transactions, are scarcity, efficiency, futurity, working rules and limiting factors under volitional control. These reveal themselves in a negotiational, or behavioristic, psychology of persuasion and coercion in bargaining transactions, command and obedience in managerial transactions, argument and pleading in rationing transactions. Transactions determine legal control, while the classical and hedonic economics was concerned with physical control. Legal control is future physical control. The three social relations implicit in transactions are conflict, dependence and order. Social philosophies differ economically according to the kind of transactions which they place uppermost.

The difficulty in defining a field for the so-called institutional economics is the uncertainty of meaning of an institution. Sometimes an institution seems to mean a framework of laws or natural rights within which individuals act like inmates. Sometimes it seems to mean the behavior of the inmates themselves. Sometimes anything additional to or critical of the classical or hedonic economics is deemed to be institutional. Sometimes anything that is "economic behavior" is institutional. Sometimes anything that is "dynamic" instead of "static," or a "process" instead of commodities, or activity instead of feelings, or mass action instead of individual action, or management instead of equilibrium, or control instead of *laissez faire,* seems to be institutional economics.[1]

All of these notions are doubtless involved in institutional economics, but they may be said to be metaphors or descriptions, whereas a *science* of economic behavior requires

analysis into similarities of cause, effect or purpose, and a synthesis in a unified system of principles. And institutional economics, furthermore, cannot separate itself from the marvelous discoveries and insight of the classical and psychological economists. It should incorporate, however, in addition, the equally important insight of the communistic, anarchistic, syndicalistic, fascistic, cooperative and unionistic economists. Doubtless it is the effort to cover by enumeration all of these uncoordinated activities of the various schools which gives to the name institutional economics that reputation of a miscellaneous, nondescript yet merely descriptive, character of so-called "economic behavior," which has long since relegated the crude Historical School.

If we endeavor to find a universal circumstance, common to all behavior known as institutional, we may define an institution as collective action in control, liberation and expansion of individual action.

Collective action ranges all the way from unorganized custom to the many organized going concerns, such as the family, the corporation, the trade association, the trade union, the reserve system, the state. The principle common to all of them is greater or less control, liberation and expansion of individual action by collective action.

This control of the acts of one individual always results in, and is intended to result in, a gain or loss to another or other individuals. If it be the enforcement of a contract, then the debt is exactly equal to the credit created for the benefit of the other person. A debt is a duty enforced collectively, while the credit is a corresponding right created by creating the duty. The resulting social relation is an economic status, consisting of the expectations towards which each party is directing his economic behavior. On the debt and duty side it is the status of conformity to collective action. On the credit and right side it is a status of security created by the expectation of the said conformity. This is known as "incorporeal" property.

Or, the collective control takes the form of a *tabu* or prohibition of certain acts, such as acts of interference, infringement, trespass; and this prohibition creates an economic status of liberty for the person thus made immune. But the liberty of one person may be accompanied by prospective gain or loss to a correlative person, and the economic status thus created is exposure to the liberty of the other. An employer is exposed to the liberty of the employee to work or not to work, and the employee is exposed to the liberty of the employer to hire or fire. The typical case of liberty and exposure is the goodwill of a business. This is coming to be distinguished as "intangible" property.

Either the state, or a corporation, or a cartel, or a holding company, or a cooperative association, or a trade union, or an employers' association, or a trade association, or a joint trade agreement of two associations, or a stock exchange, or a board of trade, may lay down and enforce the rules which determine for individuals this bundle of correlative and reciprocal economic relationships. Indeed, these collective acts of economic organizations are at times more powerful than the collective action of the political concern, the state.

Stated in the language of ethics and law, to be developed below, all collective acts establish relations of rights, duties, no rights and no duties. Stated in the language of individual behavior, what they require is performance, avoidance, forbearance by individuals. Stated in the language of the resulting economic status of individuals, what they provide is security, conformity, liberty and exposure. Stated in language of cause, effect or purpose, the common principles running through all of them are the principles of

scarcity, efficiency, futurity, the working rules of collective action and the limiting and complementary factors of economic theory. Stated in language of the operation of working rules on individual action, they are expressed by the auxiliary verbs of what the individual can, cannot, must, must not, may or may not *do*. He "can" or "cannot," because collective action will or will not come to his aid. He "must" or "must not," because collective action will compel him. He "may," because collective action will permit him and protect him; He "may not," because collective action will prevent him.

It is because of these volitional auxiliary verbs that the familiar term "working rules" is appropriate to indicate the universal principle of cause, effect or purpose, common to all collective action. Working rules are continually changing in the history of an institution, and they differ for different institutions; but, whatever their differences, they have this similarity that they indicate what individuals can, must, or may, do or not do, enforced by collective sanctions.

Analysis of these collective sanctions furnishes that correlation of economics, jurisprudence and ethics which is prerequisite to a theory of institutional economics. David Hume found the unity of these three social sciences in the principle of scarcity and the resulting conflict of interests, contrary to Adam Smith who isolated economics from the others on assumptions of divine providence, earthly abundance and the resulting harmony of interests. Institutional economics goes back to Hume. Taking our cue from Hume and the modern use of such a term as "business ethics," ethics deals with the rules of conduct arising from conflict of interests, arising, in turn, from scarcity and enforced by the *moral* sanctions of collective *opinion;* but economics deals with the same rules of conduct enforced by the collective economic sanctions of *profit* or *loss* in case of obedience or disobedience, while jurisprudence deals with the same rules enforced by the organized sanctions of *violence*. Institutional economics is continually dealing with the relative merits and efficiency of these three types of sanctions.

From this universal principle of collective action in control, liberation and expansion of individual action arise not only the ethical concepts of rights and duties and the economic concepts of security, conformity, liberty and exposure, but also of assets and liabilities. In fact, it is from the field of corporation finance, with its changeable assets and liabilities, rather than from the field of wants and labor, or pains and pleasures, or wealth and happiness, or utility and disutility, that institutional economics derives a large part of its data and methodology. Institutional economics is the assets and liabilities of concerns, contrasted with Adam Smith's Wealth of Nations.

But collective action is even more universal in the unorganized form of custom than it is in the organized form of concerns. Custom has not given way to free contract and competition, as was asserted by Sir Henry Maine. Customs have merely changed with changes in economic conditions, and they may today be even more mandatory than the decrees of a dictator, who perforce is compelled to conform to them. The business man who refuses or is unable to make use of the modern customs of the credit system, by refusing to accept or issue checks on solvent banks, although they are merely private arrangements and not legal tender, simply cannot continue in business by carrying on transactions. These instruments are customary tender, instead of legal tender, backed by the powerful sanctions of profit, loss and competition, which compel conformity. Other mandatory customs might be mentioned, such as coming to work at seven o'clock and quitting at six.

If disputes arise, then the officers of an organized concern—a credit association, the manager of a corporation, a stock exchange, a board of trade, a commercial or labor arbitrator, or finally the courts of law up to the Supreme Court of the United States—reduce the custom to precision by adding an organized sanction.

This is the common-law method of making law by the decision of disputes. The decisions, by becoming precedents, become the working rules, for the time being, of the particular organized concern. The historic "common law" of Anglo-American jurisprudence is only a special case of the universal principle common to all concerns that survive, of making new law by deciding conflicts of interest, and thus giving greater precision and organized compulsion to the unorganized working rules of custom. The common-law *method* is universal in all collective action, but the technical "common law" of the lawyers is a body of decisions. In short, the common-law method is itself a custom, with variabilities, like other customs. It is the way collective action acts on individual action in time of conflict.

Thus collective action is more than *control* of individual action—it is, by the very act of control, as indicated by the aforesaid auxiliary verbs, a *liberation* of individual action from coercion, duress, discrimination, or unfair competition by other individuals.

And collective action is more than control and liberation of individual action—it is *expansion* of the will of the individual far beyond what he can do by his own puny acts. The head of a great corporation gives orders whose obedience, enforced by collective action, executes his will at the ends of the earth.

Thus an institution is collective action in control, liberation and expansion of individual action.

These individual actions are really *trans*-actions instead of either individual behavior or the "exchange" of commodities. It is this shift from commodities and individuals to transactions and working rules of collective action that marks the transition from the classical and hedonic schools to the institutional schools of economic thinking. The shift is a change in the ultimate unit of economic investigation. The classic and hedonic economists, with their communistic and anarchistic offshoots, founded their theories on the relation of man to nature, but institutionalism is a relation of man to man. The smallest unit of the classic economists was a commodity produced by labor. The smallest unit of the hedonic economists was the same or similar commodity enjoyed by ultimate consumers. One was the objective side, the other the subjective side, of the same relation between the individual and the forces of nature. The outcome, in either case, was the materialistic metaphor of an automatic equilibrium, analogous to the waves of the ocean, but personified as "seeking their level."

But the smallest unit of the institutional economists is a *unit of activity*—a transaction, with its participants. Transactions intervene between the labor of the classic economists and the pleasures of the hedonic economists, simply because it is society that controls access to the forces of nature, and transactions are, not the "exchange of commodities," but the alienation and acquisition, between individuals, of the *rights* of property and liberty created by society, which must therefore be negotiated between the parties concerned before labor can produce, or consumers can consume, or commodities be physically exchanged.

Transactions, as derived from a study of economic theories and of the decisions of courts, may be reduced to three economic activities, distinguishable as bargaining

transactions, managerial transactions and rationing transactions. The participants in each of them are controlled and liberated by the working rules of the particular type of moral, economic or political concern in question.[2]

The bargaining transaction derives from the familiar formula of a market, which, at the time of negotiation, before goods are exchanged, consists of the best two buyers and the best two sellers on that market. The others are potential. Out of this formula arise four relations of possible conflict of interest, on which the decisions of courts have built four classes of working rules.

1. The two buyers are competitors and the two sellers are competitors, from whose competition the courts, guided by custom, have constructed the long line of rules on fair and unfair competition.

2. One of the buyers will buy from one of the sellers, and one of the sellers will sell to one of the buyers, and, out of this economic choice of opportunities, both custom and the courts have constructed the rules of equal or unequal opportunity, which, when reduced to decisions of disputes, become the collective rules of reasonable and unreasonable discrimination.

3. At the close of the negotiations, one of the sellers, by operation of law, transfers title to one of the buyers, and one of the buyers transfers title to money or a credit instrument to one of the sellers. Out of this double alienation and acquisition of title arises the issue of equality or inequality of bargaining power, whose decisions create the rules of fair and unfair price, or reasonable and unreasonable value.[3]

4. But even the decisions themselves on these disputes, or the legislative or administrative rules prescribed to guide the decisions, may be called in question, under the American System, by an appeal to the Supreme Court, on the ground that property or liberty has been "taken" by the governing or judicial authority "without due process of law." Due process of law is the working rule of the Supreme Court for the time being, which changes with changes in custom and class dominance, or with changes in judges, or changes in the opinions of judges, or with changes in the customary meanings of property and liberty.

Hence the four economic issues arising out of that unit of activity, the bargaining transaction, are competition, discrimination, economic power and working rules.

The habitual assumption back of the decisions in the foregoing classes of disputes is the assumption of equality of willing buyers and willing sellers in the bargaining transactions by which the ownership of wealth is transferred by operation of law. Here the universal principle is scarcity.

But the assumption back of managerial transactions, by which the wealth itself is produced, is that of superior and inferior. Here the universal principle is efficiency, and the relation is between *two* parties, instead of the *four* parties of the bargaining transaction, The master, or manager, or foreman, or other executive, gives orders—the servant or workman or other subordinate must obey. Yet a change in working rules, in course of time, as modified by the new collective action of court decisions, may distinguish between reasonable and unreasonable commands, willing and unwilling obedience.

Finally the rationing transactions differ from managerial transactions in that the superior is a collective superior while the inferiors are individuals. Familiar instances are the log-rolling activities of a legislature in matters of taxation and tariff; the decrees of

communist or fascist dictatorships; the budget-making of a corporate board of directors; even the decisions of a court or arbitrator; all of which consist in rationing either wealth or purchasing power to subordinates without bargaining, although the negotiations are sometimes mistaken for bargaining, and without managing, which is left to executives. They involve negotiation, indeed, but in the form of argument, pleading, or eloquence, because they come under the rule of command and obedience instead of the rule of equality and liberty. On the borderline are partnership agreements which ration to the partners the benefits and burdens of a joint enterprise. These rationing transactions, likewise, in the American system, are subject finally to the working rules (due process of law) of the Supreme Court.

In all cases we have variations and hierarchies of the universal principle of collective action controlling, liberating and expanding individual action in all the economic transactions of bargaining, managing and rationing.

Since institutional economics is behavioristic, and the behavior in question is none other than the behavior of individuals while participating in transactions, institutional economics must make an analysis of the economic behavior of individuals. The peculiar quality of the human will in all its activities, distinguishing economics from the physical sciences, is that of choosing between alternatives. The choice may be voluntary, or it may be an involuntary choice imposed by another individual or by collective action. In any case the choice is the whole mind and body in action—that is, the will—whether it be physical action and reaction with nature's forces, or the economic activity of mutually inducing others in the transaction.

Every choice, on analysis, turns out to be a three-dimensional act, which, as may be derived from the issues arising in disputes, is at one and the same time, a performance, an avoidance, and a forbearance. Performance is the exercise of power over nature or others; avoidance is its exercise in one direction rather than the next available direction; while forbearance is the exercise, not of the total power except at a crisis, but the exercise of a limited degree of one's possible moral, physical or economic power. Thus forbearance is the limit placed on performance; performance is the actual performance; and avoidance is the alternative performance rejected or avoided—all at one and the same point of time.

It is from forbearance that the doctrine of reasonableness arises, while performance means either rendering a service, compelling a service, or paying a debt, but avoidance is non-interference with the performance, forbearance or avoidance of others. Each may be a duty or a liberty, with a corresponding right or exposure of others, and each may be enforced, permitted, or limited by collective action according to the then working rules of the particular concern.

If institutional economics is volitional it requires an institutional Psychology to accompany it. This is the psychology of transactions, which may properly be named negotiational psychology. Nearly all historic psychologies are individualistic, since they are concerned with the relation of individuals to nature, or to other individuals, treated, however, not as citizens with rights, but as objects of nature without rights or duties. This is true all the way from Locke's copy psychology, Berkeley's idealistic psychology, Hume's skeptical psychology, Bentham's pleasure-pain psychology, the hedonistic marginal utility psychology, James's pragmatism, Watson's behaviorism, and the recent *Gestalt* psychology. All are individualistic. Only Dewey's is socialistic.

But the psychology of transactions is the psychology of negotiations. Each participant is endeavoring to influence the other towards performance, forbearance or avoidance. Each modifies the behavior of the other in greater or less degree. This is the psychology of business, of custom, of legislatures, of courts, of trade associations, of trade unions. In popular language it resolves into the *persuasions* or *coercions* of bargaining transactions, the *commands* and *obedience* of managerial transactions, or the *arguments* and *pleadings* of rationing transactions. All of these are negotiational psychology. It may be observed that they are a behavioristic psychology.

But these are only names and descriptions. A scientific understanding of negotiational psychology resolves it into the smallest number of general principles, that is, similarities of cause, effect or purpose, to be found in all transactions, but in varying degree. First is the personality of participants, which, instead of the assumed equality of economic theory, is all the differences among individuals in their powers of inducement and their responses to inducements and sanctions.

Then are the similarities and differences of circumstance in which personalities are placed. First is scarcity or abundance of alternatives. This is inseparable from efficiency, or the capacity to bring events to happen. In all cases negotiations are directed towards future time, the universal principle of futurity. Working rules are always taken into account, since they are the expectations of what the participants can, must or may do or not do, as controlled, liberated or expanded by collective action. Then, in each transaction is always a limiting factor whose control by the sagacious negotiator, salesman, manager or politician, will determine the outcome of complementary factors in the immediate or remote future.

Thus negotiational psychology is the transactional psychology which offers inducements and sanctions according to the variable personalities and the present circumstances of scarcity, efficiency, expectation, working rules and limiting factors.

Historically this transactional psychology may be seen to have changed, and is changing continuously, so that the whole philosophies of capitalism, fascism or communism are variabilities of it. In the common-law decisions it is the changing distinctions between persuasion and coercion or duress, persuasion being considered the outcome of a reasonable status of either equality of opportunity, or fair competition, or equality of bargaining power, or due process of law. But economic coercion and physical duress are denials of these economic ideals, and nearly every case of economic conflict becomes an assumption or investigation, under its own circumstances, of the negotiational psychology of persuasion and coercion. Even the managerial and rationing negotiations come under this rule of institutional change, for the psychology of command and obedience is changed with changes in the status of conformity, security, liberty or exposure. The modern "personnel" management is an illustration of this kind of change in negotiational psychology.

All of this rests on what may be distinguished as three social relations implicit in every transaction, the relations of conflict, dependence and order. The parties are involved in a conflict of interests on account of the universal principle of scarcity. Yet they depend on each other for reciprocal alienation and acquisition of what the other wants but does not own. Then the working rule is not a foreordained harmony of interests, as assumed in the hypotheses of natural rights or mechanical equilibrium of the classical and hedonic schools, but it actually creates, out of conflict of interests, a workable mutuality and

orderly expectation of property and liberty. Thus conflict, dependence and order become the field of institutional economics, builded upon the principles of scarcity, efficiency, futurity and limiting factors derived from the older schools, but correlated under the modern notions of working rules of collective action controlling, liberating and expanding individual action.

What then becomes of the "exchange" of physical commodities and the production of wealth, as well as the consumption of wealth and satisfaction of wants by consumers, which furnished the starting points of the classical, hedonic, communist and other schools of economists? They are merely *transferred to the future*. They become expectations of the immediate or remote future, secured by the collective action, or "institution," of property and liberty, and available only after the conclusion of a transaction. Transactions are the means, under operation of law and custom, of acquiring and alienating legal control of commodities, or legal control of the labor and management that will produce and deliver or exchange the commodities and services, forward to the ultimate consumers.[4]

Institutional economics is not divorced from the classical and psychological schools of economists—it transfers their theories to the *future* when goods will be produced or consumed or exchanged as an outcome of present transactions. That future may be the engineering economics of production of the classical economists or the home economics of consumption of the hedonic economists, which depend on *physical* control. But institutional economics is *legal* control of commodities and labor, where the classical and hedonic theories dealt only with physical control. *Legal control is future physical control*. Future physical control is the field of engineering and home economics.

Thus it may be seen how it was that the natural rights ideas of the economists and lawyers created the illusion of a framework, supposed to be constructed in the past, within which present individuals are supposed to act. It was because they did not investigate collective action. They assumed the fixity of existing rights of property and liberty. But if rights, duties, liberties and exposures are simply the changeable working rules of all kinds of collective action, looking towards the future, then the framework analogy disappears in the actual collective action of controlling, liberating and expanding individual action for the immediate or remote future production, exchange, and consumption of wealth.

Consequently the final social philosophy, or "ism"—which is usually a belief regarding human nature and its goal—towards which institutional economics trends is not something foreordained by divine or natural "right," or materialistic equilibrium, or "laws of nature"—it may be communism, fascism, capitalism. If managerial and rationing transactions are the starting point of the philosophy, then the end is the command and obedience of communism or fascism. If bargaining transactions are the units of investigation then the trend is towards the equality of opportunity, the fair competition, the equality of bargaining power, and the due process of law of the philosophy of liberalism and regulated capitalism. But there may be all degrees of combination, for the three kinds of transactions are interdependent and variable in a world of collective action and perpetual change, which is the uncertain future world of institutional economics.

NOTES

1 Cf. *Proceedings,* Amer. Econ. Assn. Suppl., March, 1931, pp. 134 ff.; *Amer. Econ. Rev.,* March, 1931, pp. 67 ff.; Atkins and others, *Economic Behavior* (1930).

2 Cf. *Commons, Legal Foundations of Capitalism,* pp. 47 ff. (1924).

3 Cf. article "Bargaining Power," John R.Commons, *Encyclopaedia of Social Sciences*.

4 On this subject see Commons, "The Delivered Price Practice in the Steel Market," *Amer. Econ. Rev.,* September, 1924. Also F.A.Fetter, *The Masquerade of Monopoly* (1931).

35
THE PROBLEM OF CORRELATING LAW, ECONOMICS AND ETHICS*

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In these latter days physics, chemistry and astronomy have been correlated by the discovery of a *unit of activity* common to all of them. Roughly speaking, the former units in physics had been molecules, the units in chemistry had been atoms, the units in astronomy had been planets and stars. And the "energies" which made these units move were heat, electricity, chemical affinity, gravity. But nowadays the unit common to all of them is a unit of activity, the interaction of electrons and protons. The concept of energy disappears. Four hundred million million vibrations per second is the color red in the human mind, but it is that many wavelengths in physics, chemistry and astronomy.

This analogy roughly describes the problem of correlating law, economics and ethics. It is the problem of discovering a unit of activity common to them.

In the field of economics the units had been, first, Ricardo's commodities and the individuals who produced commodities, while the "energy" was human labor. Then the units continued to be the same commodities, but the individuals became those who consumed commodities, and, at the hands of Menger and Jevons, the "energy" became the stimuli of wants, depending upon the quantity and kind of the commodity. In either case, by analogy to physical science, these opposing energies of labor and want, magnified into "elasticities of supply and demand," could be physically correlated in terms of tendency towards an equilibrium at Ricardo's "margin of cultivation" or Menger's "marginal utility." This correlation was accomplished by the "neo-classicists," led by Alfred Marshall (1890).

There was no need of a further correlation with law or ethics—in fact these latter were avowedly excluded, because the relations on which the economic units were constructed were relations between "man and nature" and not between "man and man." One was Ricardo's relation between human labor and the resistance of nature's forces; the other was Menger's relation between the quantity wanted of nature's forces and the quantity available. Neither statute law, nor ethics, nor custom, nor judicial decision had anything to do with either of these relationships.

We know that the historical and ethical schools of economists, led by Schmoller and others,[1] revolted against these doctrines, but these schools, even in their culminating form of the "ideal typus" as proposed by Rickert and Max Weber,[2] never were able to incorporate into what remained merely descriptions or ideals of historical process the economic *principles* derived from Ricardo and Menger. This, however, can be done if we discover a unit of activity, and if we define "principles" as mere similarities of cause, effect or purpose common to these activities.

The courts of law deal with human activity in its relation, not of man to nature, but of man to man. But they deal with this activity only at a certain point, the point of conflict of interests between plaintiff and defendant. But economic theory, based on relations of man to nature, had no conflict of interests in its units of investigation, since its units were commodities and individuals. These ultimate units produced, in fact, a harmony of interests rather than a conflict of interests. Hence the ultimate unit to be sought in the problem of correlating law, economics and ethics is a unit of conflicting interests.

But this is not enough. The ultimate unit of activity must also be a unit of mutually dependent interests. The relation of man to man is one of interdependence as well as conflict.

But still further, this ultimate unit must be one which not only is continually repeating itself, with variations, but also one whose repetitions are expected by the participants to continue in the future substantially similar to what they are in the present and have been in the past. The unit must contain security of expectations.

Thus the ultimate unit of activity which correlates law, economics and ethics must contain in itself the three principles of conflict, mutuality and order. This unit is a transaction.

But when we analyze transactions we find that they resolve themselves into three types, which may be distinguished as bargaining transactions, managerial transactions and rationing transactions. These are functionally interdependent, and their interdependence constitutes the whole which, following American usage, we name a going concern. A going concern is a joint expectation of beneficial bargaining, managerial and rationing transactions, kept together by "working rules." When the expectations cease, then the concern quits going.

This going concern is itself a larger unit, and is analogous to that which in biology is an "organism," or in physics a "mechanism." But its components are not living cells, nor electrons, nor atoms—they are transactions which transfer ownership. By a study of the theories of economists, in the light of decisions of courts, the bargaining unit is found to consist of four parties, two buyers and two sellers, all of whom are treated legally as *equals*. The resulting formula may be pictured in terms of the offers made by the participants, as follows:

Formula of bargaining transaction—legal equals
B \$100 B^1 \$90
S \$110 S^1 \$120

The competing buyers offer to pay \$100 and \$90; the competing sellers offer to accept \$110 and \$120. The final price will lie between \$100 and \$110.

But managerial and rationing transactions are, in law and economics, the relation of a superior to an inferior. In the managerial transaction the superior is an individual, or a hierarchy of superiors, giving orders which the inferior must obey, like the relations of foreman to worker or sheriff to citizen. But in the rationing transaction the superior is a collective superior, like a board of directors of a corporation, or a legislature, or a communist or fascist government, or a cartel, which pro-rates among inferiors the burdens and benefits of the concern. The formula of a managerial or rationing transaction is therefore the picture of a relation between *two* parties instead of four, as follows:

Managerial and rationing transactions
Legal Superior
Legal Inferior

I
BARGAINING TRANSACTIONS

It is first necessary to distinguish the double and even treble meanings of the word exchange, as used by the early economists, which served to conceal both the marketing process of bargaining from the labor process of managing, and the legal from the economic process. The concept of exchange had its historical origin from the pre-capitalistic period of markets and fairs. The merchant then was a peddler who carried his goods or coins to market and physically exchanged them with other merchants. Yet he really combined in himself two activities entirely different, not distinguished by the economists, the labor activity of physical delivery, and the legal activity of alienation of ownership. One was physical delivery of physical control over commodities or money; the other was legal delivery of legal control. The one was an exchange, the other a transaction.

The difference is fundamental and was not incorporated in economic theory. The individual does not transfer ownership. Only the state, by means of the courts, transfers ownership by reading intentions, if the court deems them reasonable, into the minds of participants to a transaction. The two kinds of transfer have been separated in capitalistic industry. Legal control is transferred at the centers of capitalism, like New York, London, or Paris, but physical control is transferred at the ends of the earth by laborers acting under the orders of those who have legal control. The transfer of legal control is the outcome of a bargaining transaction. The transportation of commodities and the delivery of physical control is a labor process of adding “place utility” to a commodity.

This labor process we distinguish as a managerial transaction. The individualistic economists necessarily read into this meaning of exchange the mutual grant of considerations, but this was treated subjectively as a pleasure-pain choice between commodities, whereas, from the legal bargaining standpoint, it is the behavioristic negotiations of persuasion or coercion between persons deemed to be equal and free, which terminate in reciprocal transfers of legal control of commodities and money.

It was the latter meaning of an exchange which the common-law judges of England, in the sixteenth century, recognized in their decisions of disputes between conflicting merchants, by taking over the bargaining customs of merchants on the markets and deciding disputes in conformity with those customs, in so far as approved. Some of these customs, when taken over by the courts, become, in Anglo-American law, partly known as the doctrines of *assumpsit* and *quantum meruit*.

Broadly interpreted these doctrines read as follows. Let it be assumed, in the ordinary course of trade, according to the custom of merchants, that, when a person had acquired a commodity or money from another person, he did not intend robbery or theft or deceit, but took upon himself the responsibility to pay for it (implied *assumpsit*);[3] and further, he did not intend, by economic coercion or physical duress, to overcome the will of the other person as to the terms of the transfer of ownership, but intended to pay or perform what was fair or reasonable *(quantum meruit)*.

This assumption of intention to accept responsibility was necessary because the courts were called upon, in case of disputes, to create a legal duty by enforcing obedience of payment or performance implied in the negotiations. And this applied not only to deferred performance or payment, but also to immediate performance or payment for cash. It is these negotiations and alienation of legal control in consideration of payment or performance that we name a bargaining transaction, leaving the physical "exchange" to the labor process of physical delivery, enforced by the law of managerial transactions, if necessary.[4]

Henceforth the courts, by making assumption as to what was going on in the minds of participants, constructed an ethical standard of the "willing buyer and willing seller," which has been the standard set up for the decision of disputes arising from bargaining transactions, whether commodity bargains on the produce markets, wage bargains on the labor markets, stock and bond bargains on the stock exchange, interest bargains on the money markets, or rent and land bargains on the real estate markets. In all of these bargains the theory of *assumpsit* and *quantum meruit* has had an explicit or implied influence.

How, then, shall the economist construct a unit of activity, the bargaining transaction, which shall fit this evolution of the common law, derived, as it is, from thousands of decisions of courts? We have already constructed the formula as above. The bargaining consists of four parties, two buyers and two sellers, each, however, governed by the past and expected decisions of the courts in case of dispute, if a conflict of interests reaches that crisis. Out of a universal formula which may thus be mentally constructed so as to include these four participants acting in line with customs approved in legal decisions, may be derived four economic and legal relations between man and man, so intimately bound together that a change in one of them will change the magnitude of one or more of the other three. They are the issues derived from a fourfold conflict of interests latent in every bargaining transaction, and the decisions of the American courts on economic disputes are readily classified in these four directions. Each decision has for its object the establishment of a working rule as a precedent which shall bring mutuality and order out of the conflict of interests.

1. The first issue is, equal and unequal opportunity, which is the legal doctrine of reasonable and unreasonable discrimination. Each buyer is choosing between the best two sellers, and each seller is choosing between the best two buyers. If a seller, for example a

railroad company or telegraph company, charges a higher price to one buyer and a lower price to that buyer's competitor, for exactly similar service, then the first buyer, under modern conditions of narrow margins of profit, is unreasonably discriminated against, and eventually is bankrupted. But if there is good ground for the discrimination, such as a difference in quantity, cost, or quality, then the discrimination is reasonable and therefore lawful.[5]

2. Another issue, inseparable from the first, is that of fair and unfair competition. The two buyers are competitors and the two sellers are competitors, and the decisions on unfair competition have built up, during 300 years, the modern asset of good will, the biggest asset of modern business.

3. The third issue, inseparable from the other two, is that of reasonable and unreasonable price. One of the two buyers will buy from one of the two sellers. The price will depend on the three economic conditions, opportunity for choice, competition of buyer with buyer and seller with seller, and equality or inequality of bargaining power between the actual buyer and the actual seller, who are nevertheless equals in law. This reasonable price is constructed, in the mind of the court, on the three assumptions of equal opportunity, fair competition and equality of bargaining power.

4. Finally, in the American decisions is the dominant issue of due process of law. The Supreme Court of the United States has authority to overrule state legislatures, the Federal Congress and all executives in all cases where they deprive individuals or corporations of property or liberty "without due process of law." If a state legislature or the Federal Congress, or a lower court, or an executive deprives either of the four participants in a transaction of either his free choice of opportunities, or his liberty of competition, or his bargaining power in fixing a price, that act of deprivation is a "taking" of both his property and his liberty, and, if the deprivation can not be justified to the satisfaction of the Supreme Court, then it is a deprivation of property and liberty without due process of law, and is therefore unconstitutional and void, and will be enjoined.[6]

Thus, if the formula of a bargaining transaction is properly constructed in the minds of both the economists and the lawyers, with its four participants and the Supreme Court, just as the formula of the atom or star has been reconstructed in physics, chemistry and astronomy with its protons, electrons and radio-activity, so also a *unit of activity* is constructed common to both law and economics, and even social ethics.

But there are two other but inseparable units of activity, the managerial and rationing transactions, each having its legal and economic equivalents.

II
MANAGERIAL TRANSACTIONS

A managerial transaction grows out of a relation between two persons instead of four. One is a legal superior who has the legal right to issue commands. The other is a legal inferior who, while the relation lasts, is bound by the legal duty of obedience. It is the relation of foreman and worker, sheriff and citizen, manager and managed.

From the economic standpoint the managerial transaction is the one whose purpose is the production of wealth, including what we have already named as the physical meaning of exchange considered as the adding of "place utility" to commodities; whereas the bargaining transaction has for its purpose the distribution of wealth and the inducements to produce and deliver wealth.

Psychologically and ethically, also, the managerial transaction differs from the bargaining transaction. While the ethical psychology of bargaining transactions is that of *persuasion or coercion,* depending on opportunity, competition and bargaining power, because the parties, although deemed to be legally equal, may be economically unequal (coercion) or economically equal (persuasion), yet the ethical psychology of managerial transactions is *command and obedience* because one is both legally and economically superior and the other is legally and economically inferior.

This managerial transaction, in the case of labor, is inseparable from, but distinguishable from, the bargaining transaction. As a bargainer, the modern wage-earner is deemed to be the legal *equal* of his employer, induced economically by persuasion or coercion, but once he enters the place of employment he becomes legally *inferior,* induced by commands, which he is required to obey. The distinction is clear if the two sets of terms are distinguished as the bargaining terms of employer and employee, or rather proprietor and wage-earner, and the managerial terms of foreman and workman.

Here again is a double meaning of the historic word "exchange," based on failure to make use of the distinction between bargaining' and managing. The proprietor, in modern industry, has two representatives, the agent and the foreman. The agent is one whose acts are deemed legally to bind his principal, the employer, on the doctrine of agency, which again implies the ethical assumptions attributed to the previously mentioned *assumpsit* and *quantum meruit*. But the foreman is not, as such, an agent, though for some purposes, such as liability for accidents, his behavior may bind the employer. He may be an agent, but he is mainly only another employee placed in charge of the technological process. The distinction has been made clear by the modern differentiation of the "employment department" from the "production department." The employment department is governed by the law of principal and agent; the production department by the law of manager and managed. Historically the production department traces back to the law of master and servant, owner and slave.

Apparently, therefore, no place was left in the traditional economic meaning of the word "exchange" for this institutional distinction. Hence the word "exchange" is now found to have had a third meaning—the "exchange" of the laborer's product with a foreman, which is not an exchange at all, but is merely physical delivery under orders, and the other meaning of transfer of ownership by the laborer of his product to the proprietor in consideration of the transfer of ownership of money by the proprietor to the laborer. The latter is the bargaining transaction, with its *assumpsit* and *quantum meruit,* and the laborer is a wage-earner; the former is the managerial transaction, and the laborer is just a bundle of the labor power of Ricardo and Marx.

Recent economic theory, since the incoming of "scientific management," has furnished two pairs of terms and two units of measurement which permit this double meaning of "exchange" to be clearly distinguished. The units of measurement are the man-hour and the dollar. The pairs of terms are input-output and outgo-income. Scientific management has restored the labor-theory of Ricardo and Marx, but under the name of

efficiency. The ratio of output per hour (physical goods) to input per hour (average labor) is the measure of efficiency. This is not an "exchange" at all—between the worker and the foreman—it is the physical process of overcoming the resistance of nature under the supervision of management. The unit of measurement is the man-hour.

But the unit of measurement in the bargaining transaction is the dollar. It measures the ratio of outgo to income. The outgo is the alienation of ownership. The income is the acquisition of ownership. The dollar, then, is the measure of relative scarcities in bargaining transactions, while the man-hour is the measure of relative efficiencies in managerial transactions.

There are many cases at common law setting down the rights and duties of these managerial transactions, distinguished from bargaining transactions. They may be summarized as the right of the employer to control the behavior of those who are his employees. Hence the managerial transaction consists of the superior and the inferior, each governed by the law that has been created by the decision of disputes arising out of managerial transactions.

III
RATIONING TRANSACTIONS

Finally, rationing transactions differ from the other two in that they are the negotiations of reaching an agreement among several participants who have authority to apportion the benefits and burdens to members of a joint enterprise. The simplest case is a partnership transaction as to sharing the burdens and benefits of a joint enterprise. A little more complex is the activity of a board of directors of a corporation in making up its budget for the ensuing year. Quite similar is the activity of members of a legislature in apportioning taxes and agreeing on a protective tariff, known as "log-rolling" in America. The so-called "collective bargaining," or "trade agreement," is a rationing transaction between an association of employers and an association of employees, or between an association of buyers and an association of sellers. Dictatorship and all associations for control of output, like cartels, are a series of rationing transactions. A judicial decision is a rationing by the court of a certain quantity of the national wealth to one person by taking it forcibly from another person. In these cases there is no individual bargaining, for that would be bribery, and no managing which is left to subordinate executives. There is simply that which is sometimes named "policy-shaping," but which, when reduced to economic quantities, is the rationing of wealth or purchasing power, not by parties deemed equal, but by an authority superior to them in law.

These three units of activity exhaust all the activities of the science of economics. Bargaining transactions transfer wealth by voluntary agreement between legal equals. Managerial transactions create wealth by commands of legal superiors. Rationing transactions apportion it by agreements between legal superiors. Since they are units of social activity they are legal and ethical as well as economic.[7]

IV
ASSETS AND PROPERTY

The two aspects, the economic and the legal, which we are endeavoring to distinguish and then correlate in the concept of a going concern, turn on the meanings of property and liberty. The term property cannot be defined except by defining all the activities which individuals and the community are at liberty or required by law to do or not to do with reference to the object claimed as property. These activities are the three types of transactions. The only reasons for making claims of ownership in the negotiations of transactions is expected scarcity. Even radio wavelengths are now reduced to property, by rationing transactions, on account of their expected scarcity, by prescribing who may make use of them and when. But scarcity is also a fundamental concept in economics. Both Ricardo's labor theory of value and Menger's diminishing utility theory of value were personifications of scarcity in terms of the activities required and satisfactions obtained in dealing with nature's limited resources.

If the principle of scarcity, then, is ultimate for both law and economics, it follows that the term property has a double meaning, the economic meaning of scarcity and futurity, known by lawyers as the *"res"* or "property-object," and the legal meaning of "property-rights," i.e. working rules enforced by the community upon individuals in their transactions respecting that which is expected to be scarce.[8] This economic meaning of scarcity and futurity is expressed by the terms assets and liabilities, while, as we shall see, the legal meaning of property rights is right, duty, liberty, and exposure.

The usefulness of this terminology, based on two aspects of the principle of scarcity, will be found in the enlarged meanings which the Supreme Court of the United States has given to the terms property and liberty as used in the Federal Constitution, the supreme law of the land. This Constitution, including the Fifth Amendment (1791) and the Civil War amendments (especially the Fourteenth, 1868), contains three provisions governing all legislative and executive authorities, whether state or Federal, in effect as follows:

1. Private property shall not be taken for public use without just compensation.
2. No state shall pass any law impairing the obligation of contracts.
3. No person shall be deprived of property or liberty without due process of law.

Out of the enlargements of meaning of the above terms-property, liberty, person and due process of law, as used in the Constitution-there are now to be distinguished three meanings of property in the sense of *assets (res),* as distinguished from property in the sense of *rights*. Each of these meanings is both economic and legal. The word "person" has come to mean a corporation owning assets, as well as a former slave. Property *(res)* as decided in the Slaughter-house Cases,[9] meant "corporeal" property, namely, lands, machinery, slaves; and liberty meant the bodily liberty of the former slaves. Property also then had the meaning of "incorporeal" property, which is the obligation and negotiability of debts. And the third meaning of property, not admitted by the majority in Slaughter-house Cases, but now known as "intangible" property, while it originally arose from the goodwill cases 300 years ago, arose also under the Fifth and Fourteenth Amendments to the Constitution from the later decisions of the Supreme Court enjoining legislatures against reducing the prices charged by business enterprises. To reduce prices by

legislative enactment is now a "taking" of property, although it takes only the *value* of the property, just as much as is the physical taking of corporeal property, and this, since 1890,[10] can be done only to the extent approved by the Supreme Court as consistent with "due process of law."

Thus the three American meanings of property, as an economic asset, have arisen from the practice of the English and American courts in taking over the existing customs of private parties, in so far as deemed applicable and good, and giving to them the physical sanctions of sovereignty. In the feudal and agricultural stage property was mainly corporeal. In the mercantile stage (seventeenth century in England) property became also the incorporeal property of negotiable debts. In the stage of corporate capitalism of the past forty years property becomes also the intangible property of liberty to charge whatever prices the seller can obtain. These meanings of both property and liberty, in construing the Constitution, were revolutionized by the Supreme Court in a line of decisions between the years 1872 and 1897, and the revolution consisted in enlarging the meaning of property and liberty from physical commodities and human bodies to bargaining transactions.[11]

V
LIBERTY AND EXPOSURE

These changes in the meanings of the economic content of property as assets and liabilities have required a deeper analysis of the meanings of the term "rights" as used in jurisprudence. This analysis was materially advanced by Professor Hohfeld of the Yale Law School in 1913, and by the Yale law faculty in the development of Hohfeld's analysis.[12] On the basis of their analysis the following formula is constructed showing a correlation of legal,

Formula of legal, economic and behavioristic correlation

	Sanctions		*Inducements*			*Sanctions*	
Working Rule	*Economic Status*	*Legal Relation*	*Bargaining Transaction*		*Legal Relation*	*Economic Status*	*Working Rule*
Can	Security	Right	B	B^1	Duty	Conformity	Must, must not
Cannot	Exposure	No right	S	S^1	No duty	Liberty	May
May	Liberty	No duty[13]			No right	Exposure	Cannot
Must, must not	Conformity	Duty			Right	Security	Can

economic and behavioristic concepts, in so far as they apply to bargaining transactions. The "legal relations" are from Hohfeld; the "economic status" is the correlative assets

and liabilities; the "working rules" are individual action as controlled by collective action.

The distinction is required, first, between inducements and sanctions. Inducements are the economic incentives offered by the participants to each other, either persuasion or coercion, depending on the economic relation of opportunity, competition and power. Sanctions are the collective inducements applied to individuals by the concern which more or less controls his behavior.

These sanctions are distinguishable as moral, economic and physical sanctions, depending upon the kind of concern which exercises control. The legal sanction is physical force, and the concern is the state. The formula is drawn to fit the legal sanctions, but the same formula is applicable to moral and economic sanctions. The moral sanction is enforced by such concerns as churches, social clubs and ethical associations like the many "trade associations" of businessmen who formulate a "code of ethics" whose enforcement rests only on the collective opinion of the members, unsupported by economic or physical penalties. The economic sanctions are enforced by such organizations as trade unions, business corporations, or cartels, with the economic sanctions of employment or unemployment, profit or loss.

These moral and economic concerns have also their "courts" which decide disputes, under such names as "trials for heresy," "commercial arbitration," or "labor arbitration," performing functions similar to those in courts of law, but without the physical sanctions of the state imposed by the legal judiciary. In short, the formula applies to all collective action in control of individual action whether it take the form of moral, economic, or political concerns. It is, however, out of this universal formula of collective control of individual action that the common-law courts derive their habitual assumptions whenever the physical power of the state is called upon to decide disputes that cannot be decided by the use of moral or economic pressure.[14]

The universal principle, or similarity of cause, effect, or purpose, which we can derive mentally from all observations of collective control of individual action, we name a "working rule." It is these working rules which, in the decisions of American courts, are known as "due process of law." They are not something fixed and eternal, or divine, as was assumed by the natural rights school of jurisprudence, but are simply the changeable rules which, for the time being, in view of changing economic conditions, the courts accept in issuing their commands to disputants in a litigation. We can distinguish, as suggested by the analysis and terminology of the Hohfeld School of law, four different aspects of these commands, each of which gives rise to a correlative capacity or incapacity of the opposite party to the dispute. If the court orders the defendant to perform a service, to pay a debt, or to avoid interference with the plaintiff, then the auxiliary verbs "must" or "must not" are directed towards the defendant. Correlatively this means that the plaintiff has the "power" to call upon the collective force of the state to aid him in enforcing his will upon the defendant who must or must not. This power is, behavioristically, designated by the auxiliary "can."

On the other hand, if the court refuses to compel the defendant to act or not to act, then the plaintiff "can not" call upon the state to enforce his will, and correlatively the defendant is in the position that he "may" do as he pleases in the matter at issue.

Since, however, there is a reciprocal relation between the parties to the transaction, the plaintiff also "may" do as he pleases in other aspects of the matter at issue, and the

defendant "can not" have the aid of the state in enforcing his will on the plaintiff. But, if the plaintiff is commanded also to perform or pay or avoid interference on his side of the transaction, then, as before, the auxiliaries "must" or "must not" are correlative to the auxiliary "can".

In this way, it is the changeable working rules of a concern, expressed as the opinion of the court in using the sanctions of the concern, which determine what each party to a transaction can, cannot, may, must or must not do.

Converting these behavioristic determinations into corresponding economic equivalents, there are four economic positions which the individual may occupy in his transactions, each of which places him in an "economic status" relative to other parties. The state establishes for him security of expectations in so far as it requires conformity to those expectations on the part of others. Or, if the court withholds the aid of the physical sanctions, then the one party is at liberty to do as he pleases and the other is exposed to gain or loss equivalent to the exercise of their liberty by the others.

When we turn further to the correlative legal terminology, a "right" indicates that the individual "can" call on the state for security of expectations by imposing a duty of conformity by injunction or mandamus on others, whereas, if no duty is imposed on either party, then the economic relations are the reciprocal liberties and exposures of the parties to the exigencies of what, in economics, is "free competition."

This analysis and correlation enables us to distinguish three meanings of property which have evolved in the decisions of the Supreme Court during the past sixty years. The Constitution of the United States (Fifth and Fourteenth Amendments) prohibits the national and state legislatures from "taking" property or liberty without due process of law. In a leading case in 1872[15] the court held that the meaning of property was corporeal property and the meaning of liberty was freedom from slavery. To "take" property or liberty, at that time, meant the working rule that a state must not deprive a person of his security in doing as he pleased with corporeal goods or his own corporeal body. This was the physical meaning of corporeal property, and had no relation whatever to the value of the property.

To "take" property also meant, at that time, to deprive a person of his right to call upon the state to enforce a duty of performance or payment, the economic correlative of which is a credit, or asset, and its equivalent debt or liability. This was "incorporeal property," an economic magnitude of value.

Quite different is intangible property, a meaning of property which came into the American decisions after 1890. If it is decided that there is no duty (Hohfeld's "privilege") in the case at issue, there is, of course, no right. The economic equivalent of no-duty is liberty, and the economic equivalent of no-right is the equivalent exposure to the liberty of the other. The exposure of an employer to loss is equal to the liberty of the laborer to refuse to work. Then, if each party is treated equally, there is a mutuality of liberty and exposure, as seen in the above formula. This is the meaning of a bargaining transaction which fixes prices or wages, and of "intangible" property, distinguished from "incorporeal." The intangible property which it recognizes is all those expectations of future beneficial transactions, known generally as the goodwill of a business, or good credit, or good reputation, or that goodwill of wage-earners known recently as "industrial goodwill,"[16] all of which were formerly known as "liberty" but are now known as property. Henceforth, if a state or the Congress reduces the *prices* charged by a railroad

corporation, or endeavors to equalize bargaining power between employers and employees, this reduction of prices, or this deprivation of bargaining power, is a "taking" of property, although what it takes is the *value* of the property and not the property.

Thus the meaning of "property" as used in the Constitution was changed from physical goods to bargaining power, and the meaning of "liberty" from freedom of bodily movement to freedom of bargaining power.

VI
TIME

Finally, the question arises, What becomes of the traditional concept of commodities as employed since the time of Smith and Ricardo? Traditionally economists, except the communists and anarchists, have avowedly excluded property rights from their theories of economics, assuming them to be either natural and immutable, or else as having no economic significance. In 1856 MacLeod[17] endeavored to found a system of political economy solely on property rights. But his theory was discarded by all economists as counting the same thing twice, once as a physical thing and once as the right to the thing.

The difficulty was that neither the economists nor MacLeod had correctly analysed *time,* a concept which is of the essence of a unit of activity. Consequently they could make no precise distinctions between past, present, and future. "The present," for MacLeod, was *one year of time,* wherein he confused time with the measurement of time. "The present" for economists was the current events. But if we define "the present" as a moving *point* of time (mathematics), or a moving *instant* of time without measurable dimensions (Bergson), between the incoming future and the outgoing past, then there is no double meaning of property (assets) and property rights. Assets are always the present value of *expectations* of future economic activities, immediate or remote, always keeping ahead of the moving present; but transactions are the joint behavior of participants always occurring at the moving instant of time which we name the present. Hence, instead of double counting we have the future and the present of the same unit of economic activity, which has both its legal and economic reference. Proprietary rights, duties, liberties, and exposures are the lawful expectations; commodities and money are the economic expectations; transactions are the present activity in view of the expectations. Hence the economist's commodities do not disappear—they are projected into the future and become *future commodities,* the expected outcome of managerial, bargaining and rationing transactions.

Then the court, if a dispute arises, reads into the transaction, as inferred from the intentions of the parties, or from the intentions of the legislature, or from its own pragmatic philosophy of public policy, by means of various ethical doctrines, which together we name *habitual assumptions,* certain expectations for the future, relative to commodities, prices or money, and it is these which are the rights, duties, liberties, and exposures of property.

This mental process we have already mentioned in the doctrines of *assumpsit* and *quantum meruit*. When once settled by a decision these habitual assumptions become, by the doctrine of precedent, the expectations of all parties regarding the future economic consequences of their present transactions. This is simply the principle of anticipation, common to all human behavior.

The foregoing injection of the time factor into economic theory makes it possible to extend to both judicial decisions and to the human will itself, the principle of limiting and complementary factors which economists have been using in a limited way for many decades, especially since the writings of Karl Menger (1873). It is the economist's way of putting the "part-whole" relation, and is an economic concept of the will-in-action. The limiting factors are always the actually present factors upon which the human will is now operating, knowing by experience that the complementary factors, of their own inherent forces, will probably work out the results intended. Thus a very little potash, if that is the limiting factor, will multiply the yield per acre from say five bushels to twenty-five bushels. Other parties are the limiting factors in the several kinds of transactions. Then when that limiting factor is controlled or supplied, another of the complementary factors becomes the limiting one, and it must be controlled or supplied. Hence the complementary factors are always in the future, immediate or remote, taken for granted and relegated to the realm of the unconscious, but the limiting factor is always the one consciously operated on at the present point of time.

So judicial decisions may be limiting or complementary factors in the economic transactions. If complementary they are taken for granted and it is confidently assumed that they will be as they have been. They become habitual assumptions. But if a dispute arises and must be carried to court, then judicial decision becomes the limiting factor, and everything waits upon the lawyers who are trying to get a favorable decision. Thus the principle of limiting and complementary factors, when *future time* is introduced, is both an economic concept of the will itself and a formula for what we now distinguish as the *theoretical* correlation of law and economics.

VII
CUSTOM

The term custom has a sociological and a legal meaning. Sociologically it is the control over individual action enforced by collective moral or economic sanctions. Legally it is the added control exercised by the courts in their use of physical sanctions, according to the method of deciding disputes. A precise definition of custom is far more important in American jurisprudence than it is in continental or even in British jurisprudence, on account of the American federal system of government. With forty-eight states and a federal Congress enacting laws, and with the conflicting fields of the federal and state laws vaguely outlined by the Federal Constitution, the Supreme Court becomes the final authority which determines uniformity of law throughout the nation. The court therefore necessarily looks to something superior to all legislatures as its standard of uniformity,

and this something may be broadly described as "custom." Even the Constitution itself, the supreme law, is interpreted according to the changing customs of business and industry, with their moral sanctions of collective opinion and their economic sanctions of gain or loss. Custom is converted into a new common law-common for all the states—by the decisions of disputes as they arise. Each decision is a precedent which may be followed or distinguished in what are deemed to be similar or dissimilar cases.

It is this doctrine of precedent that gives unique character to the Supreme Court of the United States as the supreme law-making body. An examination of the writings of continental jurists, who follow what Gény[18] calls the "traditional method," reveals to an American a curious difficulty on their part in getting away from the dominance of codes and acts of the legislature. Those writers seem to be apologetic if they introduce custom, or, usage, or Gény's "free decision," or "free scientific research," as a source of law. But these variations from statutes and codes give little or no trouble to the Supreme Court of the United States. Statutes are declared void as conflicting with the Constitution of the United States whenever they take property or liberty without what the Court declares to be due process of law. Even if not declared void they are so construed as to fit the court's changeable meanings of property, liberty, person and due process in the particular dispute at issue. In some cases dissenting justices have quite accurately named this a "nullification" of the statute, or "judicial usurpation," or "veto."

Then these meanings themselves are avowedly changed from time to time by the gradual process of "exclusion and inclusion," so that, as above stated, the Constitution is itself amended in course of time by merely changing the meanings of the economic and juridical terms, property, liberty, person, and due process of law. Since there is no appeal from the Supreme Court, except by the extreme process of constitutional amendment, which requires a three-fourths vote of the states, or by civil war such as that of 1861 which freed the slaves, it follows that the court is continually making and remaking the law by the judicial process of deciding disputes. This, for Anglo-Americans, is the common-law method of making law, but in America it reaches a height of authority unknown elsewhere because the Supreme Court is the final authority, superior to legislatures, states and executives, wherever a difference is asserted by the Court itself between its meanings given to words and the meanings given elsewhere. Since it is the economic customs and precedents from which the court's interpretations are derived, it follows that the common-law method of making law by deciding disputes is itself what we may designate an *actual* correlation of law and economics.[19]

It will be seen from the foregoing how urgent it is in the United States, more than it is in other countries, to develop fundamental theories of the correlation of economics and jurisprudence. The state and federal supreme courts are final authorities on acts of legislatures in all regulations of property, liberty and persons under the "due process" clauses of their constitutions. The issue usually arises in a suit brought by a citizen or corporation (going concern) against the state or federal officials, asking for a writ prohibiting the enforcement of the law, on the ground that it conflicts with the Federal Constitution and its Bill of Rights. The Supreme Court, then, on the basis of the findings of fact and the conclusions of the lower court, whether a state Supreme Court or a lower Federal court, passes upon the legislative act or the administrative order, as to whether it conflicts with the superior law of the Constitution. Everything turns on the court's definitions of property, liberty, person, and due process.

By the common-law method of making law, the highest courts are not bound, in fact, to follow precisely any former meanings which they have given to these terms, but they avowedly state that their method is one of “exclusion and inclusion.” By this is meant that a meaning given in a former decision may have been too broad or too narrow to fit the issue in the instant case. If too broad, then the precedent from the former case does not apply and is not binding on the court. This is the process of “exclusion.” If the former meaning was too narrow, then that precedent can be extended to furnish the rule for the instant case, and this extension is binding on the court. This is the process of “inclusion.” This, of course, is the fundamental process of analogy, clearly enunciated by Gény, and as practised in the common-law method of reporting cases, the courts devote much of their attention in their lengthy opinions to this mental process of inclusion and exclusion. It is by this process of analogy that the meanings of property, liberty, person, and due process have been gradually changed.

These opinions are often published as dissenting opinions along with majority opinions, and hence it is possible to see how it is that the social philosophies of the individual judges lead them to different conclusions on the same statement of facts. The “personality of the judge” stands out clearly in any comparative study of these majority and minority opinions. Indeed, to expound fully the term “due process of law” is to expound a complete social philosophy.[20]

The lower courts are bound to follow the law established by majority opinions, although they often propose innovations which become new precedents if the Supreme Court affirms or permits.[21] But the Supreme Court of the United States itself is not, in fact, thus bound, and it can and does create new law and thereby follows out literally Gény’s “method of free decision.” Eventually it may, and often does, happen, as above stated regarding the Slaughter-house Cases of 1872, that the minority opinion becomes the majority opinion, as it did in that line of cases, in 1897. This occurs by the simple process of changing the meanings of words by exclusion and inclusion.

With this documentary material to work upon, American economists have given considerable attention to the Supreme Court’s divergent and changing theories of value which grow out of their changing meanings of property and liberty and rest ultimately on their social philosophies. The American federal and state supreme courts actually carry out what Gény appears to set up as the ideal of what the courts *ought* to do. I may not interpret Gény as he intends but I take it that the following is the order of importance of his analysis of the elements of the judicial process, and it certainly is the one that fits the process of the American Supreme Court. It may be named the process of reasoning and valuing:

1. Intuitions of what is relatively important in promoting justice and general utility. These we name habitual assumptions.

2. Selection of facts by the process of exclusion and inclusion, which is the process of analogy, guided by these intuitions.

3. Weighing the facts mentally in accordance with these intuitions of their relative importance.

4. Classification of the facts in accord with this selection and weighing.

5. Logical deduction from the habitual assumptions which guided the selection, weighing and classification.

6. The whole is guided by Gény's "practical common sense" which, however, is only another name for the intuitions, or habitual assumptions, with which we started.[22]

VIII
INVESTIGATION

If this is the circular process, as it seems to be, not only of judicial but of all reasoning and valuing by people not judges, then the practical question arises as to Gény's search for something outside the habitual assumptions and deductive reasoning of the courts. The need for scientific investigation arises from the changes in economic conditions from individualism to collectivism, from individuals to corporations, which make the habitual assumptions perhaps inapplicable to the modern "going concerns." But American courts are not so constituted, or do not have the agencies for making such extensive investigations as would be required. Hence some of the American legislatures and the Federal Congress have attempted to provide exactly this investigation by the creation of "commissions."

An extreme case is the Wisconsin State Industrial Commission. The commission has jurisdiction over many of the transactions of employers and employees. It has not only its staff of expert investigators, but it also has advisory committees of employers, employees, physicians, engineers; architects, economists, numbering some two hundred persons in all. The investigations, findings and conclusions on health, safety, accident compensation, child labor, hours of labor, etc., are governed by the "due process of law" provisions as interpreted by the courts. Therefore, provision is made for review by the court, but in such review no new testimony is permitted that had not previously been submitted to the commission. If new testimony is offered, the court is required to refer the case back to the commission, giving to the commission opportunity to consider it and revise its findings, if the commission so determines. In this way the trial court, with its strict rules of legal evidence, makes no investigations and takes no testimony whatever. It listens only to arguments, and it passes only on the due process of law of the commission's procedure.

Other states and the Federal Congress have not gone as far in this direction towards separating investigation from the procedure of the courts. Nevertheless, these American commissions are spreading out so as to cover practically all the fields of economic conflict, such as the conflicts of labor and capital, buyers and sellers, farmers and wholesalers, borrowers and lenders, and different classes of taxpayers. They are a device by which the traditional separation of legislative, executive and judicial powers, although required by the written constitutions, is nevertheless attempted to be avoided by combining in one body a process which, in law, is neither legislative, executive nor judicial. They are sometimes described as quasi-judicial, or quasi-legislative bodies, but their function is that of investigation. The law merely gives effect to the commission's conclusions drawn from its findings and weighing of the facts, if they are found by the court to conform to due process. In short, these commissions are the American discovery,

during the past three decades, of a *practical* method of correlating law and economics by Gény's "scientific investigation of the nature of things."

IX
SUMMARY

Thus we have, in the American common-law method of making new law by the decision of disputes, three aspects of the problem of correlating law and economics. The *theoretical* aspect of limiting and complementary factors; the *actual* process of deciding disputes in conformity with approved customs and precedents; the *practical* process of investigation by commissions.

The subject-matter in all cases is a unit of activity, but this unit has its three inseparable forms of bargaining transactions, managerial transactions and rationing transactions, united in going concerns.

Since it is human activities that we are investigating, our analysis resolves them into similarities of cause, effect, or purpose, which we name principles. Four such similarities are distinguishable, derived from the writings of economists and jurists, which become the principles of scarcity, efficiency, futurity and the working rules of custom and going concerns.

That which in law is named property arises from the principle of scarcity in economics. It comes to the front in bargaining and rationing transactions. But it is inseparable from the principle of efficiency which is the increase of supply brought about by overcoming the resistance of nature's forces through managerial transactions.

These, again, are inseparable from the principle of futurity, which on the juristic side is rights, duties, liberties, exposures, and on the economic side is future commodities and money. But working rules are the principle of collective action in control of individual action, mainly under the aspect of precedent, which is the common-law method of controlling individual action by the decision of disputes.

These four principles are the inseparable interaction of similarities of cause, effect or purpose, and, if a general principle is sought which shall include all of them and shall be the ultimate principle underlying the correlation of law, economics and ethics, distinguishing the social sciences from physical and biological sciences, this may be named the principle of willingness, defined as the whole of all the similarities of cause, effect or purpose in all bargaining, managerial and rationing transactions that constitute going concerns.

NOTES

* Comments on François Gény, *Méthode d'interpretation et sources en droit privé positif* (1899, 1919), contributed to the volume to be published in honor of Gény.

1 Cf. Commons, "Das Anglo-Amerikanische Recht und die Wirtschaftstheorie," in 3 *Die Wirtschaftstheorie der Gegenwar*t (1928) 292–317.

2 Rickert, *Die Grenzen der Naturwissenschaftlichen Begriffsbildung* (1902); Weber, "Die Objektivität der socialwissenschaftlichen und sozialpolitischen Erkenntnis" (1904) 19 *Archiv. f. Sozialw.* 22.

3 Slade's Case, 4 Rep. 92b (1602), which summarizes a preceding century of decisions on particular aspects of *assumpsit*.

4 This distinction between physical delivery of physical control and legal alienation of legal control became of fundamental importance in what was known as the "delivered price" system widely adopted in American business. In one case, known as the "Pittsburgh-plus" case, the issue was whether a free competitive market existed when the custom of the business made the price of the commodity that at the *place* of alienating legal control, that is, the thousands of places of physical delivery to customers, rather than at the place of manufacture. The economists in that case argued that legal title should pass at the place of manufacture, in order that all customers might compete at that place. See Commons, "The Delivered Price System in the Steel Market" (1924). 14 *Amer. Econ. Rev.* 505.

5 W. U. Tel. Co. *v.* Call Pub. Co., 181 U. S. 92 (1901).

6 Cf. Commons, *Legal Foundations of Capitalism* (1924). Summarized by Voegelin, *Ueber die Form des Amerikanischen Geistes* (1928) 172–238; Kröner, "John R. Commons, seine wirtschaftstheoretische Grundfassung," Heft 6, *Diehls Untersuchungen zur theoretischen Nationaloekonomie* (1930); Lewellyn, "The Effect of Legal Institutions on Economics," (1925) 15 *Amer. Econ. Rev.* 665; "What Price Contract? An Essay in Perspective," (1931) 40 *Yale L. J.* 704; Grant, "The Natural Law Background of Due Process" (1931) 31 *Col. L. Rev*. 56.

7 I take it that the Fascist philosophy of Othmar Spann (*Fundament der Volkswirtschaft,* 1923) and the Communist philosophy of Karl Marx are based solely on managerial and rationing transactions, for I find in their theories no analysis of bargaining transactions as these have been developed by economists or by the common law decisions. Managerial and rationing transactions are based on command and obedience between those who are legally superior and inferior, and they lead to a social philosophy of dictatorship. Bargaining transactions are based on persuasion or coercion between those who are legally equal, depending economically upon opportunity, competition and bargaining power, and they lead to a social philosophy of liberty.

8 These distinctions are derived from David Hume's unification of law, economics and ethics on the common principle of scarcity. See 2 *Philosophical Works of David Hume,* edited by T.H.Green and T.H.Grose (reprint 1898) 188.

9 16 Wall. 36 (1872).

10 Minnesota Rate Case, 134 U. S. 418 (1890); *Commons, Legal Foundations,* 15.

11 Cf. *ibid.* 11–46.

12 Hohfeld, "Some Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1913) 23 *Yale L. J.* 16; Corbin, "Legal Analysis and Terminology" (1921) 29 *Yale L. J.* 163.

13 Hohfeld uses "privilege" instead of "no duty."

14 For these and other reasons, the formula of correlation of law and economics does not mean that there is an identity between the legal relation and the economic quantities. It means only that the same legal relation holds for all economic quantities, no matter how large or small the debt, the liberty, the exposure, etc. Nor does it mean that the practices of individuals or of moral or economic concerns exactly conform to any rigid rule that judges lay down in their decisions. The formula represents a precise correlation only in a particular dispute where the judge actually decides what the particular disputants shall do or not do. Outside these disputes are billions of transactions that never get before the courts. In other words, it is only a generalized "formula" to aid the mind in the process of analysis of legal and economic relations. Yet, if they do come before the court, the formula contains all the possible legal and

economic relations that can be used in reaching a decision on the case, or that can be found in the billions of variable transactions, or practices, from which the court derives its reasoning.

15 Slaughter-house Cases, 16 Wall 36 (1872).

16 Cf. Commons, *Industrial Goodwill* (1922).

17 *Theory and Practice of Banking, Elements of Economics.* See criticism by Böhm-Bawerk,

18 Rechte und Verhaeltnisse (1871), who avowedly excluded “rights and relations,” the latter including such “relations” as goodwill; also criticism by 1 Knies, *Der Kredit* (1876), 63.

19 In his *Méthode d’interpretation et sources en droit privé positif* (1899, 1919).

20 An excellent account of the way in which this has come about, and one that parallels Gény’s interpretation of the philosophy of Rousseau embodied in the code, which is the same philosophy as the Bill of Rights in the United States Constitution, is the article by Grant, “The Natural Law Background of Due Process” (1931) 31 *Col. L. Rev.* 56. Grant concludes: “Under the guise of the supremacy of the law, we have established the supremacy of the judges.”

21 This was done, for example, in the leading case of Hurtado *v.* Cal., 110 U. S. 516 (1884). See Commons, *Legal Foundations* 333.

22 An illustration was the change in the meaning of “good-will” proposed by a lower court, Consolidated Gas Co. *v.* City of New York, 157 Fed. 849 (1907), and affirmed by the Supreme Court, Wilcox *v.* Con. Gas Co., 212 U. S. 19 (1909), although in doing so the Supreme Court reversed the same lower court which had followed former decisions of the Supreme Court. On these cases see Commons, *Legal Foundations* 191.

23 The leading case, Smyth *v.* Ames, 169 U. S. 466 (1897), contains explicitly much of what is here more fully elaborated. The case pertained to railway valuation.

36
THE PLACE OF ECONOMICS IN SOCIAL PHILOSOPHY

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There are as many social philosophies as there are individuals. I name them Habitual Assumptions. They have a physical foundation. But I leave that to physiology. There is no need of being too profound. I notice that the fundamentalists in economics were talking metaphors drawn from the deism of Adam Smith, or the cosmology of Newton, or the chemistry of Lavoisier, or the biology of Darwin, according to whatever non-human discipline seemed fundamental. Theirs is the metaphorical stage of the science. The science of economics needs only its own behavioristic foundations. Habitual Assumptions are as deep as it is necessary to go. I can investigate assumptions in each individual whom I interview or whose writings I read in my economic research, from the topmost capitalist to the downmost menial; from the pure theorist to the politician; from the Supreme Court to the practicing lawyer. The assumptions of each help me to understand his meanings of words and to interpret and tie together his empirical language. If I could tie together all of his Habitual Assumptions I should have his social philosophy. Perhaps this might be named his personality.[1] Social philosophy is the whole of which Habitual Assumptions are the parts.

But, more than in his language, which is empirical, imperfect, even deceptive, I find his Habitual Assumptions in his transactions with other people. He does not know even himself as he really is, until he acts. His economic acts are his transactions.

Habitual Assumptions have a social, as well as a physiological foundation. I name this Custom. It differs from habit in that it is collective guidance of the individuals' assumptions and transactions. I call it institutional economics. It is investigated or assumed by courts in cases of disputes arising from conflicts of interest. They make assumptions drawn from custom when they read intentions into individuals, as they do when they infer from what similar individuals do under similar circumstances.

In order to bring these unorganized customs into transactions where economists can investigate them I give to them the institutional name, collective action in control of individual action.

Custom, for example, has not given way to contract. Contract is itself a modern custom, some 300 years old and continually changing. Custom means, in economics, that the individual cannot make a living or continue in business unless he adapts himself to

what his competitors, customers, employees and others are doing. Bank checks are an instance. The business man who refuses to accept or issue bank checks cannot continue in business. They are not legal tender enforced by law. They are customary tender enforced by scarcity of alternatives.

To give another example, it is customary for corporations to lay off employees and thus to restrict output, maintain prices and create unemployment whenever profits seem about to disappear. Being customary in a capitalistic civilization, this is deemed to be “natural.” It was not customary with southern slave-owners. If farmers or laborers restrict output to maintain prices by concerted action it is “unnatural” because not customary.

I name these and similar instruments of collective control an economic sanction, to distinguish it from the physical sanction of sovereignty. The economic sanction operates through scarcity of alternatives, often more powerful than a legal mandate sanctioned by the physical force of sovereignty. There are also the moral sanctions of collective opinion, revealing themselves in their characteristic similarity of acts without economic pressure or governmental duress.

So also with other classes besides those mentioned. They must adapt themselves to what others are doing. This process of adaptation is the process of Habitual Assumptions in the form of custom. It enables the individual to have more or less confidence in the future and to exercise his will without thinking.

Collective action has innumerable organized forms, like corporations, unions, cooperatives, political parties, ecclesiastical organizations. These are the Custom of Association. Individuals come and go but the association goes on. Individuals are no longer the mere individuals of the classical economic theory—they are members, citizens of a concern, with rights and liberties conferred or withheld by associated action. In the habits of business these organized customs are named “going concerns” if they are expected to go. This name is latterly taken over by the courts. The fact that they are “going” gives to them a money value far beyond that of their scrap value. They live in the future but act in the present, as do all human beings. A nation, or a family, or a church, is a “going concern.” To the strictly economic concerns, however, as well as to the individual’s economic expectations, a money-value can be and is given at a present point of time when the transaction of transferring ownership is made. In the case of going concerns, these are the values of stocks and bonds, or the values of real estate. Ownership—not the materials owned—is the valuable thing in economics for which prices are paid, because ownership is the expectation that future collective action will control future individual action.

But ownership is the product of institutions. Institutions themselves are various forms of collective action controlling, more or less, individual action through the expectations of future physical, economic or moral sanctions.

By giving this definition of collective action to institutions, I find that they include all of the habitual assumptions of all economists and plain people. They include what the fundamentalists are driving at in their metaphors. They include what are called laws, codes, by-laws, rules and regulations, which, however, in order to include unorganized customs and to indicate their changeability, I name the working rules of collective action for the time being. Working rules are for social philosophy what “natural law” is for cosmic philosophy, and, in the metaphorical stage of the science, what so-called “natural law” is for economics. Metaphorical economists continue to speak of “economic law,” or

the "laws of economics," on the analogy of Newton's eternal unchanging cosmic laws of gravity which cannot be violated with immunity. But they are the habitual assumptions of the economists themselves. Let institutions change, either suddenly, as in Russia, Italy, Germany, or centuries ago in England, France, America, or gradually, as in all countries, then the "natural" laws also change. But economic laws are artificial anyhow because they proceed from the human will, not from gravitation.

For this reason collective control over individuals is incomplete. It is incomplete on account of differences in personality, not found in the subject matter of the natural sciences. Instead of "laws" I speak of similarities of the human-will-in-action. A working rule of collective action is evidenced by a similarity of individual acts. And a similarity of action is a principle, not a law. Such are the principles of scarcity, of efficiency, of futurity, of collectivity, all of them measurable variabilities of the active human will in its economic transactions.

Economics is a special case of habitual assumptions. It differs from others in that it is quantitative. Economics is quantitative social philosophy. It has units of measurement, collectively imposed on individuals. Anything that can be measured by units thus imposed, even the expected future which exists only in the mind, is quantitative and objective, it may be a debt. A debt is a quantitative duty. Good-will is quantitative liberty. Value, in economics, is quantitative and objective. Debt, good-will, value, though existing in mental images of the future, have a present money-value as agreed upon in a transaction which transfers their ownership. So with units of physical measurement. They measure expected use-values.

But these units of measurement are themselves collective devices. Individuals cannot live in society unless they use the same units of measurement. They are the custom of quantitative language, the language of number. These units of measurement become habitual assumptions in all economic transactions. They make quantitative the expectations of the future. I name them economic quantities, because they contain futurity, not the physical quantities of the classical and communist economists.

The early materialistic economists could not grasp the idea that the future is objective and quantitative. To be objective for them a "thing" must be something material that can be produced and consumed. Their concept of Time was a mere abstraction, existing only in the mind and having no objective existence. Hence they had no place for credits and debts or the good-will of a going business. These were "rights and relations" created by law, custom, or society, and had no place in economics.[2]

Such economists were of two schools, the so-called classical economists, beginning with Adam Smith but culminating in Karl Marx, and the hedonistic economists of the past seventy years, though they began with Jeremy Bentham in the same year, 1776, as Smith. The classicists and communists were rightly called materialists; the psychologists were called sensationalists, though each school was really materialist because each founded its theories on physical control and use of materials.

They could not handle time theoretically. They did handle it empirically on their uninvestigated assumptions, the classicists in their concept of production by means of labor-power whose unit of measurement they made an average hour of labor, the hedonists in their concept of the diminishing utility of useful things wanted now or in the future by the consumer during the time of consumption.

Time is indeed subjective. It exists only in the human mind. Material nature knows nothing of time. Hence materialist economists excluded it. Man reads time into nature from the needs of his own existence. It is his most inveterate habitual assumption. His existence in society rests upon it. Time measurement is a custom. Collective action imposes units of time upon him.

It is, indeed, Time that separates human nature from material nature, and social philosophy from cosmic philosophy. Man is a time-being. Others are timeless. One of the measurements of time is the measurement of debt. Debt is the quantity of duty. A duty of one is also an equal right of another. Credit is the quantity of a right, exactly the same in measurement as the quantity of duty. I know there are other meanings of duty, but economics requires a quantitative meaning with units of measurement. A legal duty is only an ethical duty, derived from conflicts of interest, taken over from custom and enforced by the collective action of physical force, with its legal units of measurement. A debt is not a commodity, as early economists contended, with their materialistic meanings—it is a duty, measured, enforced and transferred by law. A banker speaks of his "money" on deposit. But it is not money and it is not deposited—it is sold. It is quantitative duties of other people. So inveterate is the materialism of the human mind. A debt is, indeed, an "economic quantity," though not a physical quantity, because, by the legal inventions of negotiability, assignability and the enforcement of contracts, it can be bought and sold and thus made to look like a commodity. It is even a "store of value," if contracts are enforced. But it is not a commodity. It is a social relation. Its essential quality is future time existing only in the expectations of human beings to the effect that measured duties will be enforced by collective action. But it has a present value measured by money in the transactions of the moving present. The good-will of a going concern is the quantitative expectation that profitable economic transactions will be negotiated, concluded and enforced in the future, in dealings with persons who have previously no legal or ethical duties to buy, or sell, or deliver. Liberty in law and good-will in economics begin at the point where duty and debt are released. Each is in the future, but each has a measurable value in the present when transactions are negotiated. If measurable it is quantitative, but it is a quantity of expected products or means of payment to be delivered by future human activity.

Much debate has arisen among juristic writers as to the meanings of "no-duty" and its correlative "no-right." Are these mere negatives? If so, they mean all the rest of the world. As negations of duty and right they may be anything else in the world except a duty and its equivalent right. But the economist must look upon no-rights and no-duties as also social relations, not without limits but with two kinds of limits distinguishable as collective action and scarcity. No-duty, or the negation of duty, is the same as liberty; and its correlative "no-right" is the same as exposure to the liberty of the other. But collective action limits that exposure to what are considered to be the rights of the exposed party, and these rights in turn are the equivalent duties which limit the liberty of the opposite party. It is within these limits of expected liberty and exposure that the economic quantity, good-will, arises and has its limited measurable dimensions. It may be said that liberty and duty, though only ethical and legal relations, are yet, in their quantitative dimensions of good-will and debt, the economic foundations of capitalism. They are the two kinds of expectations which are bought, sold and measured by units of money at a present point of time.

Hence Time is not an abstraction. It is concrete and real, not in physical things but in the human activities of negotiating transactions intended to control future conduct by means of units of measurement imposed by collective authority. It is a buying and selling of "rights and relations," excluded by materialistic and hedonistic economists. The so-called "rights" of property, which are thus bought and sold, become the rights, duties, liberties and exposures of property, determined, measured, by collective action through its working rules and the judicial authorities when deciding conflicts of economic interests.

The other limit of liberty is the economic limit—scarcity of alternatives. A curious feature of propagandism, so-called Americanism, is the catchword liberty without noticing those whose liberty is limited by scarcity of alternatives. These limits ought to be evident in the case of extended unemployment or of the low wages or low selling prices of products. Economic science, distinguished from propaganda, discovers that one's liberty is limited by scarcity of alternatives for self, and one's exposure to the liberty of others is limited by abundance of alternatives for self.

The first economist to investigate scarcity was Malthus, in 1798. Others took it for granted, as is the case with habitual assumptions, or else handled it by metaphors. Malthus found scarcity in the increasing pressure of population with resulting poverty and war. Ricardo's metaphors, derived from Malthus and copied by Marx, found scarcity in the resistance of nature to the labor of man. Later hedonistic economists found it in the diminishing intensity of pleasure with increasing abundance, or increasing intensity of pleasure with increasing scarcity. These are empirical cases and metaphors of a universal principle. David Hume had found scarcity in the concept of property, which, economically, is the right to withhold from others what they need but do not own. The "rights" of property, distinguished from "property" itself, are the collective working rules that create rights, duties, liberties, exposures, relative to scarcity of alternatives. Scarcity in economics is property in law. The "rights" of property in law are working rules in economics.

The universal principle of scarcity is itself a special case of a larger social principle which Cohen names the principle of "polarity." The two economic poles are Scarcity and Abundance. The minute instances between may be named degrees of scarcity.

Economists recognize three changeabilities in the principle of scarcity, namely, degree, relativity and measurability. Degree varies from extreme scarcity to excessive abundance of a particular quantity—the principle of polarity. Relativity is the changeable degrees of scarcity of a particular quantity relative to those of other quantities, under the various names of exchange-value, purchasing power, bargaining power, economic power. Measurability is a special case of relativity, the changes in degree of scarcity of the unit of measurement itself, such as the dollar or the franc, relative to the changes in degrees of scarcity of all other things measured by dollars or francs. These three variabilities become the complex in the modern concept of property, which in law and economics means the scarcity-value of property.

For these reasons of variability I name scarcity a "principle" of economics instead of resorting to the older metaphors of the "laws" of economics. A principle is a similarity, not a uniformity, of action. The so-called laws of economics seem to be something predestined and handed down by something theologically called God or materialistically called Nature. But they are only variabilities in the principle of scarcity, running like a

wavering thread through all economic activity, according to the changeabilities of time and place, in degree, relativity and the unit of measurement.

On this principle of scarcity the three philosophies of economics, ethics and jurisprudence find themselves converging in these latter days. The meaning of property has been changing from the primitive corporeal property—the ownership of physical things—to incorporeal property—the ownership of debts—then to intangible property—the ownership of the scarcity-value of anything. Its scarcity-value is its price, in terms of money, varying from the high prices of extreme scarcity to the low prices, or even no price, of extreme abundance. The change in the meaning of property from corporeal things to the scarcity-value of things may be seen in decisions of the Supreme Court of the United States during the past fifty years in the public utility cases,[3] and lastly in the gold clause cases wherein the value of money was changed from the weight of corporeal property—gold—to the intangible property of the purchasing power of legal tender.

Scarcity came into the world with the origin of life; property came with the origin of intellect and collective action. Property becomes the complex of three principles of human life, scarcity, futurity, and collective action. The last named creates the "rights" of property. The rights of property are collective action and sanctions with their working rules of rights, duties, liberties and exposures.

But these are also, though not quantitatively, in the field of ethics. The philosophy of ethics has undergone many changes, from the passive concepts of divine or cosmic harmony of interests, or the utilitarian pains and pleasures of individuals, to the active concept of collective action through custom or law in creating harmony of interests, or at least order, out of the conflicts of interests arising from scarcity. Economics is the quantitative measurement of degrees of scarcity in terms of price, which is the measure of purchasing power. This is inseparable from law, and also from ethics, if ethics, like law, be conceived as arising from conflict of interests instead of the former metaphors of theological, cosmical, or utilitarian harmony of interests. Modern instances are the so-called "business ethics," "trade-union ethics," and so on, arising wherever similar economic interests organize in propagandistic associations.

Economists have also, during 150 years, been changing piecemeal their psychological foundations of the science by changes in their assumptions of human nature. Starting, in the eighteenth century "age of reason," with the assumption of man as a rational being using such counters in his calculations of value as units of labor power, or of labor pain, or of pleasure or happiness, they have gradually approached, beginning with Malthus at the end of that century, the legal concept of the human will, acting with, or without, or against, reason, into which, however, by further Habitual Assumptions, they read certain intentions or purposes, even though those intentions were not there. They change from materialistic or hedonistic assumptions and theories of value to volitional assumptions and volitional theories of value.

This change may be seen, for example, in the gradual change in the concept of cause and effect and in the related concept of transactions.

With the early materialistic economists the cause of present economic phenomena was in the Past, like all cosmic phenomena. They used a unit of past time, the man-hour, as both cause and measure of the present accumulation of material things having value. With the hedonistic economists, going back to Bentham, the cause of the present economic phenomena was in the sensations of pleasure and pain of the present moment.

But with the volitional economists causation lies in the expected consequences of present activities.

The way in which this shift from past to future in the meaning of causation came about was by gradually enlarging the economic concept of limiting and complementary factors. These are the foundations of an economic concept of the will. The human will controls nature, and even other human beings, by acting upon the factor which is the limiting, that is the scarcest, one at the time, knowing, or imagining, that the other factors will, in the immediate or remote future, change their operations by their dependence on changes in the limiting factor. Then that which had been limiting becomes complementary when once controlled, and some previously complementary factor becomes the limiting one, to be itself controlled by human action, and so on. The limiting factors are, by an allowable metaphor, in the ever-moving present point of time between the incoming future and the outgoing past. The complementary factors are in the ever-changing expectations of future acts. The limited human will cannot control everything at once. It controls the limiting or relatively scarce and uncertain factor at the present point of time, and nature is expected to do the rest. The human mind, then, in the metaphorical stage of all science, reads into nature itself this idea of cause and effect, though it does not exist in nature at all, but exists only in the human will. Nature knows nothing of limiting and complementary factors, and therefore nothing of cause and effect.

By a further extension of the economic concept of limiting and complementary factors to include strategic and routine transactions in dealings with other people, we have what can plainly be seen in all economic control by superior wills over inferiors. Routine transactions can be taken for granted, on the principle of Habitual Assumption. Strategic transactions are designed to control the routine. The control, either of physical nature or human nature, is a special case of the two general principles of scarcity and futurity, joined in the more general principles of property and collective action. The non-economic concepts of cause and effect in the cosmic philosophies of the past derive from an infinite will, that is, an unlimited will. But the economic concept derives from a finite will, that is, a limited will, because it acts in a world of varying degrees of scarcity and collective control.

An instance of the will limited by scarcity of alternatives is in the concept of bargaining transactions. These derive from the economic concept of a market. A market is something very real to every person in modern life. It is what everybody is "up against." Economists have long since analyzed it. There are four parties to a market transaction, two sellers and two buyers. A seller is limited, at the moment of the transaction, to the best two buyers on the market. The other buyers are potential or inaccessible. As a seller he chooses the better buyer who will pay the higher price and foregoes the next best or alternative lower price. A buyer, inversely, is limited, at the moment of concluding his transaction, to the "worst" two sellers. As a buyer he chooses the seller at the lower price and avoids the next worse or alternative higher price to be paid. When the negotiations are concluded between one of the sellers and one of the buyers, then that pair is off the market and the next four repeat the negotiations and transactions until all are off the market.

Out of this four-party choosing of variable and alternative buyers, sellers and prices, arise the three economic relations, namely, competition between two buyers and between two sellers; the choice of alternative buyers by a seller and of alternative sellers by a

buyer; and bargaining power, or relative economic power, between the actual buyer and seller, known historically as exchange-value. The three relations are so tied together that a change in one will change the others.

All of these are also ethical relations arising from a three-dimensional conflict of interests, known, in economics, as fair or unfair competition; equal or unequal opportunities known in law as reasonable or unreasonable discrimination; and the persuasions or coercions of equal or unequal bargaining power. The courts summarize them ethically as a willing buyer and a willing seller. Since they are ethical, if ethics arises from conflict, they require a superior authority, in case of dispute, to lay down the working rules of the game, and this superior authority is the going concern, acting through its judicial function, such as, in economics, a stock exchange, a produce exchange, a trade union, or the state. The two variable economic limits, then, on the freedom of the will of the participants in transactions, are the variable degrees of scarcity of alternatives and variable degrees of collection action superior to individual action.

This volitional theory of value is the theory used by the courts in deciding disputes. Its discovery and elaboration in economics were made by the American economists, Henry C.Carey in the decade of the 1840s and H.J.Davenport in the decade of the 1890s. It springs, in the common law, from the ethical idea of maintaining an open, free and equal market, known originally as the "market overt," in the face of "nature's" actual world of scarcity, robbery, theft, inequality, physical duress and economic coercion.

What, then, is the subject-matter of this economic, ethical, legal, complex of rights and relationships? The materialistic and hedonistic economists rejected social relations, rights and duties, as foreign to the subject-matter of economics. They started only with the individual in his relation to nature and not to man. But that basis is too fundamental. It is, in reality, incidental to, or a consequence of the transactions between men. By analysis of what goes on between individuals under collective control, there are five parties, instead of one, with the four relations of competition, opportunity, power, and due process of law. There are, indeed, other transactions which, at the extreme, exclude the liberty and equality of bargaining, such as the managerial transactions introduced into economics from the recent "scientific management," concerned mainly with man's collective control of physical nature; and the rationing transactions of communism and fascism. These three types of transactions occur in varying degrees and relativities in modern capitalism. The psychology of transactions I name Negotiational Psychology, which is objective in the sense of behavioristic and whose results can be measured.

But the subject-matter of these transactions is ownership—not the physical things owned, as was materialistically assumed. Bargaining transactions transfer ownership; managerial transactions are the owner's exercise of control over others who are admitted voluntarily by him to the use of what he owns; rationing transactions are transactions of superiors who transfer ownership regardless of consent of subordinate individuals.

Materialistic and hedonistic economists had a double meaning of property in their concept of this subject-matter of economics. It was a "commodity," a material thing which is owned and sold on the markets. They took the ownership for granted, as something self-evident from their habitual assumptions. These assumptions, in turn, are identical with what I understand to be the "common sense philosophy" of Englishmen,[4] contrasted with the American pragmatic philosophy of C.S.Peirce.[5] It was the common sense of the eighteenth century. The business of institutional economics is to bring this

common sense into consciousness where it can be examined. It does so, in this issue of the subject-matter, by separating ownership from the thing owned, and then by reuniting them on the principles of time, relativity, polarity and collective action.

The principle of Time is the sequence of events. An event occurs at a present moving point of time, without measurable dimensions, between the incoming future and the outgoing past. This event, at a present point of time—or rather "instant" of time, because in the human mind the present sensation of acting contains a little of the past and a little of the future—is a transaction which transfers ownership. The transaction, by operation of law, creates two debts, beginning at a present point of time—a debt of performance which is the duty to deliver a specified measured product, and a debt of payment which is the duty to deliver a specified number of legal tender units or their equivalent. As soon as these duties are released by lawful performance or payment, the one who acquires ownership of the product or money is at liberty to do as he pleases, within the working rules, with the physical thing or the instrument of payment. Ownership must be alienated and acquired before the will is free to act upon the thing acquired.

The distinction is between legal control and physical control. The physical control, which constitutes the kind of control envisaged by the materialistic and hedonistic economists, is moved forward into futurity. Production and consumption is theft and embezzlement if not preceded by lawful control. This lawful production and consumption may be in the immediate future where the interval of time is so short as not to be worth measuring, or in the more remote future of days, months, years. Thus, by intervals of time and by the futurity in time of physical control after legal control is obtained, the illusory common-sense identity of the two controls is broken, but the two come together in the human purposes of the future.

What, then, becomes of the Past on which materialistic economics was founded? It retreats into justifications or incriminations of present and future transactions. And what becomes of the present sensations of the hedonists? They become the transactions dated from a point of time but looking to the future where alone valuation lies, discounted, however, into a present value. In other words, an economic quantity is a discounted future quantity. It is a "present worth."

In this way economics approaches ethics and law by shifting from materialism and hedonism to limited volitionism. Ethics and law approach economics through conflicts of interest and units of measurement. Ethics approaches economics and law by changing from predestined harmony to created harmony. The three come together on the principles of time, relativity, polarity and collective action.

It is the correlation of these principles that gives us a formula of society. The concept of society, as a foundation for economics, has made three notable changes preceding or following the three revolutions of 1789, 1848 and 1917. Adam Smith was the precursor of the French Revolution which carried his theories to an extreme not contemplated by his common sense. The extreme was the abolition of all collective action in control of individuals, such as all corporations, all unions, even the state itself, but retaining and expanding, strangely enough, individual property. "Society," for them, was merely the sum total of all individuals—a population, not a society. Its economic basis was the sum total of all individual properties—a concept of "corporeal" property. The production of wealth was the sum of all individual products. Each person and thing was a separate atom, the metaphor of chemistry.

The disillusionment that followed the French Revolution led to the idolatry of society as a metaphorical entity having even a soul, a spirit, a social value, of its own. "Society" produced wealth. Philosophies of "associationism" spread in the decades of the 1830s and 1840s, culminating in the revolutions of 1848, but more sagaciously in the general incorporation laws which, in England and America, in the decade of the 1850s, created a universal right of association. That decade I cite as the beginnings of modern capitalism. Corporations were strongly opposed by Smith and his anti-monopolistic followers. But large-scale industry required them. In that decade Karl Marx formulated his materialistic theory of international communism, and in America Henry C.Carey formulated his volitional theory of value as a justification of nationalistic protective tariffs. For Carey it was nations that produced wealth and offered to individuals the choice of opportunities in acquiring shares of its ownership. His was the legal theory of economic value. By the end of the nineteenth century the Supreme Court of the United States had changed the meanings of words in the Constitution, by giving to corporations the similar rights and liberties intended for Negroes and citizens in the Thirteenth and Fourteenth Amendments, and by changing the meaning of a corporation itself from the legal entities existing only in contemplation of law and residing only in the state which incorporated them, to the economic going concerns residing in their present and expected transactions wherever they conduct their business.

This trend to associationism reached its peak in the communistic Russian Revolution of 1917 and the fascistic revolutions of Italy and other countries. Economists and statisticians have been revolutioning their theories during the past forty years to fit these various trends toward collective action, and I have attempted, in my *Legal Foundations of Capitalism* and my *Institutional Economics,* to bring together the economic and legal theories of 200 years and to interpret them on the principles of the experimental common law of England and America. The revised communistic theories are found in the writings of Nicolai Lenin, and more recently in Corey's *Decline of American Capitalism* and Strachey's *The Nature of the Capitalist Crisis*. The fascistic theories are developed by Pareto[6] in Italy and Kotany[7] in America.

I find, in this survey of economic philosophy that there have been in reality three economic theories which I name Engineering Economics, Consumption Economics, and Institutional Economics, and that they come together in the concept of collective action as a whole on the principles of time, relativity and polarity. Engineering economics belongs to the classical economists, the communist and fascist economists. It deals, not with man as a citizen with rights and duties, but as one of the forces of nature to be used like other forces. It is the science of Production and Might. Consumption economics, since the psychological economists at the end of the century, deals with man as an animal like other animals, motivated by pleasure and pain. It is the science of Wants and Satisfactions. Institutional economics deals with man as a member or citizen of many going concerns, having rights, duties, liberties and exposures looking towards the future and rationed by the concerns. It is the science of Distribution. Since rights, etc., must first be obtained before the other economic activities can lawfully be entered upon, the others are projected into future time, whereas the transactions that transfer ownership by the working rules of law occur in the moving present but looking forward to the future engineering production of wealth and the future satisfactions of consumption of wealth. Each is inseparable from but relative to the others, and each ranges in degree between its

own extremes. But they unite into a formula of society as many varieties of collective action controlling individual action.

As such, the various concerns are distinguishable as moral, economic and legal, also united in the larger concept of society. Moral concerns, like churches and clubs, exercise in these latter days only the sanctions of persuasion through collective opinion. Economics concerns exercise the sanctions of scarcity through persuasion or coercion. Legal concerns extract the sanctions of physical duress from private transactions and organize them as sovereignty.

Out of this complex of control and release of control, ethically known as duty and liberty, emerges the principle of personality of an individual, instead of either the extreme pole of individualism of eighteenth century classical and hedonistic theories or the extreme pole of collectivism of nineteenth and twentieth century communism and fascism.

NOTES

1 Cf. E.Jordan, *Forms of Individuality; an Inquiry into Grounds of Order in Human Relations* (1927).

2 The formal elaboration of this doctrine was made by one of the greatest economists, Eugen v. Böhm-Bawerk, in his *Rechte und Verhältnisse* (1881).

3 Cf. my *Legal Foundations of Capitalism* (1924).

4 Cf. Joseph Dorfman, *Thorstein Veblen and his America* (1934).

5 Charles S.Peirce, *Chance, Love and Logic* (1923, reprints of articles).

6 Vilfredo Pareto, *Trattato di sociologia generale* (1916). (Compare my notes on Pareto in my *Institutional Economics*.)

7 Ludwig Kotany, *The Science of Economy* (1934; reviewed by Commons, *Columbia Law Review,* 1935).

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INSTITUTIONAL ECONOMICS

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I am attempting in this paper to give only a theory of institutional economics as derived from the decisions of the Supreme Court of the United States. It is a venture in pure economics, distinguished from its practical applications. The latter belong to individual cases. I have endeavored to make practical applications at other times, in drafting legislative bills, or administering state laws, with the idea of bringing them within the Court's institutional meaning of reasonable value. Such practical application must be made by a state legislature, or the Congress, or an executive in enacting or administering a law. Also, a business corporation, a farmers' cooperative, or a labor union must make a practical application in carrying out a policy which the Supreme Court may perhaps not declare unconstitutional. For I think that whatever the Court thinks is reasonable it also decides is constitutional.

Economic science has not, to my knowledge, incorporated within itself a theory of reasonable value. It separates ethics, public welfare, or national public interest as a postscript, different from economic theory. But a theory of reasonable value, which shall include these postscripts, has become obligatory, in America at least, if the practical application of economic science is to be made to fit the Constitution. I shall not here consider these applications except as data from which to derive the theory.

The economic theories of the past 160 years were started, in the year 1776, with Jeremy Bentham's repudiation of Blackstone. Thereafter economists went off on theories of happiness, but courts and lawyers continued on the theory of the common law of England and America.

A primary difference between the two is that the common law is built on conflicts of interest between plaintiffs and defendants, but with the sovereign, in the person of a judge, deciding, in each case as it arises, what is reasonable between the two, both in their conflicting private interests and in the public interest for which the sovereign is responsible.

But the happiness theory started with an assumed harmony of interests. It could be none other than individualistic and cosmopolitan without any nationalistic public interest. Only an individual can feel pain and pleasure. Bentham consistently treated all individuals as a world census of population and not as national organized societies, wherein the pleasure of one is often the pain of others. Stating it in technical economic terms, Bentham started, as one may derive from what Mitchell names his "felicific

calculus,"[1] with the simplified assumption of an individual seeking his own maximum net income of happiness by seeking the maximum gross income of pleasure and reducing to a minimum his gross outgo of pain. The spread between the two was the net pleasure of happiness for the individual, but regardless, obviously, of the pains, pleasures, or happiness of other individuals.

This happiness economy was readily converted, as Bentham did, into a money economy. The individual seeks his maximum net income of money by maximizing his gross income of money and reducing to a minimum his gross outgo of money, regardless, by analogy to net pleasure, of the effect on others arising from the fact that his maximum gross sales income is the maximum amount of money that he can obtain from others as buyers, and that his minimum gross outgo of money is the smallest amount of money he is forced to pay to sellers. The spread between the two is a maximum profit or minimum loss economy,[2] regardless of the consequences to others.

Finally, when Bentham's individual becomes the collective owners of a corporation, acting as a unit, the same maximum net money income is sought for the owners as a whole, regardless of the effects on buyers of the maximum prices paid by them for products and services, or the effects on sellers of the minimum prices paid to them for materials and labor.

Since corporations are falsely treated as individuals, I name these theories maximum net-income economics instead of individualistic economics. This is a technical phrasing of the net-income maxim, "buy in the cheapest market and sell in the dearest market"; to which, in its simplified assumption, should be added, "without consideration of methods or effects on others."

I am speaking of the working hypothesis of pure self-interest, from Bentham to marginal utility. It is a maximum net-income economics. In recent years the theory has incorporated certain institutional factors, like patents, trade names, trade marks, goodwill, under such names as "imperfect competition," "monopolistic competition," "competitive monopoly."[3] Yet even with these added evolutionary complexities the theory continues to be a maximum net-income economics, regardless of others. Its characteristic problem is that of the optimum size of an individual establishment for obtaining the maximum net income of money.

But these new factors thus introduced bring to the front two additional points of view; namely, the effect on other persons and the public purpose involved. These two aspects ate combined by the Court in the meaning of reasonable value.

While a patent right may augment the net income of its owner by means of the monopolistic privilege which it affords, yet for 300 years in England and America this augmentation has been justified, for a limited period of time, as differing from other sovereign monopolies in that it is granted only for new inventions or discoveries, and thereby fulfills the public purpose of inducing individuals to augment the national wealth while endeavoring to augment their private net incomes.

And while the goodwill of a competitive business is perhaps its most valuable modern asset towards augmenting its net income, in that it lifts its owner above the level of the free competition of traditional economics, yet it differs from other monopolies in that it exists only as long as its owner fulfills the public purpose of rendering to others what they willingly agree are reasonable services at reasonable prices. The Supreme Court has definitely decided that a monopolistic corporation, like a gas company, shall not be

permitted to set up a goodwill value as a justification for charging its monopolistic prices.[4] The goodwill of a business or profession is indeed the most perfect competition known to the law. It is founded, however, on the three economic conditions, not of pleasure, pain, or maximum net income, but of equal opportunity, equality of bargaining power, and public purpose. Thus understood, goodwill is the high point of fair competition and reasonable value in the public interest, contrasted with the economics of free competition and maximum net income for private interests, regardless of others and regardless of public interest.

Goodwill is, further, the meeting point of pure institutional economics and pure net-income economics. It has two sides. On the net-income side it augments the private net income beyond that of competitors. On the institutional side it is the reasonable ethical relation towards other buyers and sellers, who are also members of the same national economy.

When the courts reduce their standard of goodwill and reasonable value to its simplest assumption, which they derive from the common law, it rests on the maxim of a willing buyer and a willing seller. In technical language this rests on the fact that the gross income of money acquired by a seller is the identical gross outgo of money given up by a buyer in a single transaction, since it is merely a transfer of ownership; whereas, in net-income economics, the net income is the spread between maximum gross income of money and minimum gross outgo of money of one party who is a buyer in one transaction and a seller in another transaction. There can arise no question of reasonableness in maximum-net-income economics. It is only a question of economic power.[5] But the institutional economics of willingness takes into account the ethical use of economic power in a single transaction where the gross income acquired by one is a transfer of ownership of the identical gross outgo alienated by another. While the one may be named the maximum net-income economics of one person in two transactions the other is the gross-income-outgo economics of two persons in one transaction.

If I trace the beginning of maximum net-income economics to Jeremy Bentham in 1776, I find the beginning of goodwill economics in the year 1620, when the judges of the highest courts of England distinguished a free trade from a restraint of trade between a buyer and a seller.[6] The goodwill concept is literally the willing-buyer-willing-seller concept. It was arrived at both negatively and positively. Negatively, a free trade was an agreement between a seller and a buyer, neither of whom, from the standpoint of public welfare, was restrained by the other or by the state. By removing all economic coercion, all duress of violence, and all psychological misrepresentation from either party to a transaction, through the decisions of the common-law courts, and leaving only honest persuasion, the resulting transaction between the two was free, equal, and willing in the reciprocity of alienating and acquiring the two ownerships. These were the ownership of money on the one side and the ownership of materials or services as valued by that money on the other side. But the positive assertion of what was thus negatively arrived at was that of a willing buyer and a willing seller. This formula has thus become for three centuries the simplified economic assumption of the English and American common law.[7]

Hence the only standard that can be used by the courts in eliminating these unfair practices and restraints from the double transfer of ownership is the standard of a willing buyer and a willing seller, who, by the very terms thus used, are free from all of these

inequalities and injustices. The nearest approach, where the standard is almost perfectly reached, is in the economic quantity known as the goodwill of a going business. Goodwill is the realized institutional economics of the willing buyer and seller.

Yet the highly valuable goodwill of a business has not, until recently, found a place in the traditional net-income economics. I take it the reason is that pure economics has been based on man's relation to nature instead of man's relation to man. This physical relation furnished a materialistic foundation for labor costs of production and for diminishing utility of consumers' physical goods. But goodwill is purely an institutional value, that is, so-called "intangible value," of man's equitable relations with other men. Its value may far exceed the cost of production or may fall far below the cost of production of physical things. And its value has no immediate relation to the satisfaction of wants. Its value is derived solely from the willingness of owners, without coercion, duress, or misrepresentation, to alienate to each other their rights of ownership. This is the simplified hypothesis of institutional economics.

Yet I do not overlook the important contributions to economic theory in the past, whether orthodox or heterodox. I correlate them with institutional economics. The classical and communistic economists used as their measure of value the man-hour of labor. This is evidently, since the incoming of scientific management, the engineering economics of efficiency. The Austrian and hedonistic economists, deriving from Bentham, used as the measure of value the diminishing marginal utility of consumption goods. This is evidently the home economics recently introduced in the college curriculum.

But institutional economics is the field of the public interest in private ownership, which shows itself behavioristically in buying and selling, borrowing and lending, hiring and firing, leasing and renting. The private interests become the field of intangible yet quantitative and measurable rights, duties, liberties, and exposures to the liberties of others. These are various aspects of rights of ownership. What we buy and sell is not material things and services but ownership of materials and services. The correlation of engineering economics, home economics, and institutional economics makes up the whole of the science of political economics.

The only net-income economist, as far as I know, who took the trouble to examine these institutional factors and then consciously to exclude them from his pure economics of man's relation to physical nature, was Böhm-Bawerk, in 1883. Others excluded them by taking them for granted without investigation. He excluded them explicitly under the names of "rights" and "relations."[8] On examination of what he meant by these terms I find that he meant all kinds of ownership, and he limited his pure economics to the physical and psychological process of producing and consuming material things. But if his pure economic man should go along the street picking up groceries, clothing, and shoes according to their marginal utility to him, he would go to jail. He must first negotiate with an owner to whom the policemen, courts, and constitution have given the right to withhold from him what he wants but does not own, until that owner willingly consents to sell his ownership. This is his exposure to the liberty of owners, and this keeping out of jail is a part of what I mean by institutional economics.

The legal right to withhold is therefore the ultimate basis of all the imperfect or monopolistic competition that has begun to creep into the pure net-income economics of

marginal utility. It may be named institutional scarcity superimposed upon the psychological scarcity of diminishing utility.

This simplified assumption of willing buyer and seller might well be taken as the starting point of all economic theory, instead of starting with self-interest. It is the ethics of economics. For goodwill is not only customers' goodwill, it is bankers' and investors' goodwill; it is the goodwill of laborers and sellers of materials, the goodwill of landlords and tenants, even the goodwill between competitors, in so far as may be deemed by the Court not inconsistent with the public interest. In short, these varieties of goodwill, from the side of net income, are the valuable expectations that other economic classes will willingly, and therefore without duress, coercion, or misrepresentation, repeat in the future their mutually beneficial transactions.

The right to withhold is also the economic foundation of reasonable value. It came up, in its modern variety of economic coercion, with the growth of large-scale industry and the mass bargaining power of thousands of stockholders acting collectively as one person under the legality of corporation finance. This collective action is not, in fact, monopoly in the historic meaning of monopoly; it is merely the historic meaning of private property itself, but operating on the grand collective scale of associated property owners withholding from others what they want until they agree to pay or work for it. When industry reached the stage of public utility legislation, as it did fifty years ago, an essential part of this legislation was that of depriving owners of a portion of their right to withhold services by commanding them to render service on the terms specified by the Supreme Court as reasonable for both sides of the bargain.

In other cases where monopoly was not recognized, and therefore the Supreme Court did not permit compulsory service or price fixing, the principle of a willing buyer and willing seller led to the law of fair competition as against the free competition of traditional economics. Economic goodwill is the law of fair competition.

But it was in the case of so-called public utility corporations that the modern version of reasonable value began to creep into exchange value. The basic principle of a willing buyer and seller was being violated by the emergence of large-scale corporations. The legislatures, under the limitations deemed reasonable by the Supreme Court, endeavored to set upper limits of price and lower limits of service within a range that the Court might deem not incompatible with the ideal of a willing buyer and a willing seller.

This principle might be named the ideal of the common law, just as maximizing net income is the ideal of individualistic economics. In either case, one or the other is the most simplified assumption of its own pure economics, and might therefore be named the first principle of the science. But in the practical application of the science to specific cases these simplified assumptions are necessarily modified by consideration of what is practicable or impracticable under all the complex circumstances of that case at that time. In such a particular case the goal, or first principle, sought to be reached by the practical man, whether of maximum net income by the individualist or of willing seller and buyer by the Court, becomes the practicable or realistic application of the abstract science to the great complexity of favorable and unfavorable circumstances in that specific case. This, in the decisions of a Court, is the meaning of reasonable value. It is reasonable because it is the nearest practicable approach which the Court, in a specified dispute up for decision, thinks it can make towards the idealistic assumption of a willing buyer and willing seller.

Reasonable value, as I define it in following the Supreme Court, is not any individual's opinion of what is reasonable. This is the usual objection raised against a theory of reasonable value. There are as many individual opinions of reasonableness as there are individuals, just as there are as many opinions of what is pleasurable or painful as there are individuals. Reasonable value is the Court's decision of what is reasonable as between plaintiff and defendant. It is objective, measurable in money, and compulsory.

Neither is the individual permitted to say that he was unwilling. In case of dispute, the Court alone, if only to prevent anarchy, says whether he was willing or not. He must adjust his will, if he can, to the Court's will.[9]

So, also, individual opinions regarding the Court's decision itself of reasonable value, and even majority and minority opinions within the Court, have as many differences as there are individuals. But the Court's decision must be obeyed, by the use of physical force, if necessary.

Hence it is not opinions or theories that must be obeyed; it is decisions, which take the form of compulsory orders, that must be obeyed. Individual members of the Court may write out their own different opinions. But these ate justifications or criminations. They are feelings, not acts. They are even not necessary except as concessions to outside opinion. It is the decision that counts, and the decision is a fiat of sovereignty. The fiat is arrived at, in this country, by a constitutional process of majority rule within the Court. Under other constitutions it may be arrived at by a dictator exercising the judicial function by appointing and removing the judges at will. It need not then be justified and cannot be criminated without free speech. In such cases it is arbitrary fiat, not reasonable fiat.

But reasonable value, in the United States, is what the constituted Court decides is reasonable, by mere fiat, not what individuals think is reasonable. There have been decisions of the Court which I personally think were unreasonable, even dictatorial and capricious.[10] Such decisions I attribute to upbringing of members of the Court in the maximum net-income economics of corporation finance. But nevertheless I and the American people must obey the decision while it lasts.[11] It is not a matter of subjective or individual opinion; it is the constitutional structure of the American judicial system that decides.

This is because the United States differs from other nations in that its sovereignty is split in two directions: the legislative, executive, and judicial branches, in the one direction, and the federal and state branches, in the other direction. Yet since the year 1890[12] the Supreme Court has held that, while in many matters the states are sovereign, yet in the one matter of economic valuations and activities the Supreme Court of the United States is sovereign over both the states and the executive and legislative branches of the federal government. In railway valuations, for example, the Court has deprived the states of their sovereignty. But even where the Court asserts state sovereignty, as in the NIRA decision, the economic acts of state sovereignty are subordinated to national sovereignty under the dominion of the Supreme Court of the United States, Any federal or state official may be brought before the Supreme Court as defendant, on petition of a private citizen or corporation as plaintiff, in a dispute over economic valuations or economic transactions. Consequently executive and legislative sovereignty, whether federal or state, in the field of economics, are subject to the national judicial sovereignty.

The Court thereby becomes, in economics, a superior branch of both the federal and the state legislatures, differing mainly in its procedure.

This should be named a nationalistic theory of economics, instead of individualistic, cosmopolitan, or communistic. It parallels the trend toward nationalism the world over during the past fifty years, especially since the World War. This nationalistic theory of value, under the sovereignty in America of the Supreme Court, I describe as an institutional theory of economics. In order to correlate it with the maximum net-income economics of the past 160 years, I name an institution collective action in control of individual action. It may be unorganized collective action, which is the meaning of custom, or organized collective action like that of a corporation, a cooperative, a trade union, or the state itself. If organized, it necessarily acts through executive, legislative, and judicial organs, whether combined or separated. There are other meanings of institutions, as I know, but I find that this meaning of collective action fits the facts of my experience.

The supreme organized collective action is the monopoly of physical force by taking violence out of private hands. This is sovereignty. There are subordinate forms of organized collective action, sanctioned by the physical force of sovereignty but authorized, in the case of business corporations, to use the economic sanctions of scarcity, or, in the case of churches or clubs, to use the merely moral sanctions of collective opinion. These subordinate forms are delegated forms, since they are created, permitted, regulated, dissolved, or prohibited by the supreme institution, sovereignty.

I date the modern recognition by the state of these delegated forms of economic collective action from the time of the general corporation laws beginning in the decade of the 1850s, and I consider this period to be the beginning of modern capitalism. These corporation laws endowed individuals with a new universal right, the right of collective action, previously outlawed as conspiracy, and not previously granted as universal but granted only as a monopolistic special privilege by a special act of the legislature. This new universal right of collective action was evidently called for by the incoming of modern widespread markets and corporation financing. Today, it is estimated, nearly 90 percent of manufactured products in this country are produced by corporations.[13] In agriculture there is authorized by the state an amazing extension of cooperative associations controlling more or less certain economic activities of individual farmers. The extent of judicial authorization of trade unions in their control of individuals is well known. Even the individual banking business is more or less controlled by the collective action of the member banks of the Federal Reserve system, subject to the Supreme Court.

With the incoming of these collective controls the older individualistic economics becomes obsolete or, rather, subordinated to institutional economics. The free-trade individual of Adam Smith and Jeremy Bentham disappears in exactly what they denounced; namely, protective tariffs, state subsidies, corporations, unions, cooperatives—all in restraint of individual free trade.[14]

If we reduce organized collective action to its simplest possible formula, we have three parties to the transaction; namely, a plaintiff, a defendant, and a judge. This is indeed the simplest formula of sovereignty itself.[15] A similar formula applies to all subordinate organizations. The three parties are clearly separated in commercial arbitration, labor arbitration, and by means of the discipline committee of a stock

exchange or a produce exchange. But the judicial function is more or less merged with the executive and legislative functions in a corporation or a dictatorship.

This judicial sovereignty over economic affairs in the United States derives from the "due process" clause of the federal Constitution. No person shall be deprived of life, liberty, or property by either an executive or a legislature or a lower court or a state or federal government without due process of law, as determined by the Supreme Court. The meaning of due process, however, has been changed by the Court within the past fifty years. Originally the term, as stated by Corwin,[16] "meant simply the modes of procedure which were due at the common law…. Today," continues Corwin, "due process means reasonable law and reasonable procedure, that is to say, what the Supreme Court finds to be reasonable in some or other sense of that extremely elastic term."

It is from this later meaning of due process of law that the economic term "reasonable value" finds its place in American economics. Reasonable value is welfare economics as conceived by the Supreme Court.

For these reasons there is in American economics a written Constitution and an unwritten constitution. The written Constitution was written in 1787 and in succeeding amendments. The unwritten constitution was written piecemeal by the Supreme Court in deciding conflicts of interest between plaintiffs and defendants. We live under this unwritten constitution; we do not even know what the written Constitution means until the Supreme Court decides a case. When we investigate reasonable value we are investigating the unwritten constitution. When we investigate the evolution of reasonable value we are investigating the Court's changes in meanings of such fundamental economic terms as property, liberty, person, money, due process. Each change in meaning is a judicial amendment to the Constitution.[17]

Thus, while the early economists, from Thomas Aquinas to John Locke, Adam Smith and David Ricardo, culminating awkwardly in Karl Marx, eliminated money and prices but made labor cost the measure of value, the institutional economics of the common law and the Supreme Court makes legal tender money and the free will of buyers and sellers the measure and standard of reasonable value.

NOTES

1 Cf. W.C.Mitchell, "Bentham's Felicific Calculus," *Political Science Quarterly,* XXXIII, 161 (1918).

2 I know that this assumption of disregard of others, in obtaining the maximum net income, will be denied by economists as involved in their theories, and that they place a natural limit on net incomes by the law of supply and demand. Yet I think they quite properly follow Adam Smith who wrote, "I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it." Smith and followers rested their case on the public interest in increase of wealth to be derived from individual initiative. But economic history shows that at times too much wealth is produced by individual initiative and at other times too little wealth is produced. This is because the law of supply and demand has a double meaning, the traditional meaning of producing and consuming material products and the institutional meaning of selling and buying rights of ownership. There are thus two laws of

supply and demand—the consumers' law and the business law. The business men buy in order to sell and they buy and sell over and over again far more often or far less often the given rights of ownership than there are products produced and delivered. But the consumer buys only once, and he buys once only as much as he wants to consume. It is a difference both in kind and in velocity. The first is a speculative law of supply and demand. It rests on the legal tradition that his profits are his own—why can he not do what he wants to do with his profits regardless of the effects on others of cycles of overspeculation and underspeculation. The second is a producers' and consumers' law of supply and demand suited to precapitalistic or home economics.

3 Cf. Edw. Chamberlin, *The Theory of Monopolistic Competition* (1933); Joan Robinson, *The Economics of Imperfect Competition* (1933); and references there cited.

4 Wilcox *v*. Cons. Gas Co., 212 U.S. 19, 42 (1909). See also lower Courts 81 Fed. 20 (1897) and 157 Fed. 849 (1907). Comment by Commons, *Legal Foundations of Capitalism,* p. 191 (1924). It must be noted, of course, that economic goodwill is not a sentiment of affection; it is an objective economic quantity which can be bought and sold, and whose value is reasonable. Goodwill is often used as a camouflage, and even the Supreme Court has confused it with debt. (Hitchman Coal Co. *v.* Mitchell, 225 U.S. 229 [1917]; *Commons, Institutional Economics,* p. 668 [1934].)

5 Maximum net income in modern economics, is maximum net profits. Statistically it is found in the income tax reports of the Internal Revenue Department. On margin for profits, that is, net income of profits, see Commons, *Institutional Economics,* pp. 526 ff. (1934).

6 Jolyffe *v.* Brode, Cro. Jac. 596 (1620). Also reported in Nov. 98, 2 Rolle 201, W.Jones 13. Commons, *Legal Foundations of Capitalism,* p. 263. This case was one where the seller of a carpenter shop agreed to refrain from competition with the buyer. The decision sanctioned what afterwards became known as a going-concern value, considerably in excess of the value of the physical plant. On the merger of common law and equity, see H.Lévy-Ullman, *The English Legal Tradition* (tr. 1935).

7 The formula of gross-income-gross-outgo applies to both selling and buying transactions. In a selling transaction the gross money income of the seller of his product or services is the identical gross money outgo of the buyer, because he merely transfers the ownership of the identical money to the seller. Reciprocally, in the same transaction, the money value of the seller's output of products of services, whose ownership is transferred by the seller, is the identical money value, at the time, of the gross income of products or services whose ownership is acquired by the buyer.

But the seller has also, in a preceding transaction, been a buyer of the materials and labor, which he then converts into his own products or services which he afterwards sells. Hence the same formula of gross-outgo-gross-income applies, but inversely, to his previous buying transaction.

This meticulous twofold formula would usually be taken as an elaboration of the obvious and a superficial and commonplace notion of money as both a medium of exchange and a measure of value. But there are certain observations in institutional economics that follow from this obvious fact.

The so-called "exchange" of money, materials or services is not an exchange of physical products or material services, as assumed by the classical and hedonistic economists. It is two transfers of two ownerships. The physical delivery occurs after the ownership is transferred. Hence the term "transaction" is appropriate instead of "exchange." A transaction means the negotiations culminating in two transfers of ownership. But ownership and its alienation are created solely by the institution of sovereignty.

Likewise, the money used as a medium of exchange and measure of value is solely a legal tender creation by sovereignty. This has been expounded recently in the gold clause decisions. If credit is used instead of money, it also is the legal creation of debt. The price, or money

value, therefore, paid by a buyer, is not, as assumed by traditional economics, a price paid for materials, or services, or labor, but is a price paid for ownership of the materials, services, or labor. The price is a valid price only because the state protects the new owner as it did the former owner. The legal test of validity is the Court's determination of willingness of each at the time of the transaction.

Again the precise time of transfer of ownership is of importance in the measurement of value. This is because two debts are created by the transaction at a point of time—a debt of payment and a debt of performance. These debts are equivalent to the value willingly agreed upon in the transaction. The debt of payment is released by a payment of legal money. The debt of performance is released by physical delivery of the materials, services, or labor, as measured by other legal units. It was this physical delivery of materials that became the subject matter of the traditional exchange-value. But it is ownership delivery that is the subject matter of institutional economics. The two were identified on account of the double meaning of a commodity, which is a physical thing which is owned.

After the date of the transaction when the two ownerships of money and commodities have been transferred by operation of law, there may be greater or less changes of values in the hands of new owners, commuted mainly as risk and interest. But at the precise date of the transaction the value of the gross outgo or gross income of materials, services, or labor are, by agreement, by contract or by debt, identical with the amount of money paid or received.

This is true, no matter how high or low, how oppressive or onerous, how coercive or intimidating, how fair or discriminatory, is the monetary price, nor how large or small is the quantity of money, materials, services, or labor power, whose ownership is alienated by one and acquired by the other.

For these reasons I do not think that institutional economics, defined, as collective action in control of individual action, is contrary to the so-called pure economics of the past, which is individual action without collective control. It is a continuation of pure economics into a higher degree of complexity by incorporating the reasonable value of willingness into the already expanding maximum net-income economics of exchange value. Reasonable value is an upper and lower limit of exchange value placed there by the American Supreme Court. Net income economics, indeed, places upper and lower limits of net income by the so-called law of supply and demand. But institutional economics places another upper and lower limit by the law of reasonable value.

8 Eugen v. Böhm-Bawerk, *Rechte und Verhältnisse* (1883).

9 The Court, in laying down the rule for ascertaining reasonable value in a particular case, states, in effect, that all conflicting theories of value must be given consideration and that to each theory must be given its "due weight"; that is, a reasonable value of the theory itself in its relation to all other theories of value, according to the facts and public purposes in that case. (Smythe *v.* Ames, 169 U.S. 466, 1898.) This is because these conflicting theories of value are really partisan theories set up by conflicting economic interests, each interest seeking for itself the maximum net income at the expense of other interests and of the public interest as a whole.

10 Cf. Robert L.Hale, "What is a Confiscatory Rate?", *Colonial Law Review,* xxxv, 1046, 1052 (1935); Edw. S.Corwin, *The Twilight of the Supreme Court* (1934).

11 There is an evolutionary principle within the Anglo-American common-law idea of willingness corresponding to the evolution of sovereignty from the time of William the Conqueror. The idea started in warlike and feudal times when only the wills of martial heroes were deemed worth while; then was extended to unwarlike merchants in the law of the market overt; then to serfs and peasants; then to the most timid of people, for whom not only actual violence or trial by battle, but even the merest subjective apprehensions of inferiority created fear which deprived them of their freedom of will. (Galusha *v.* Sherman, 105 Wis. 263, 1900.) Then towards the end of the nineteenth century this simplified formula of a free will was extended to the relations between employers and employees, on the economic assumption that employers,

being owners of property, were in a stronger economic position than propertyless laborers, such that laborers were deprived by fear of unemployment of their freedom of will in bargaining. (Holden *v.* Hardy, 169 U.S. 366, 1898.) Further variations were partly allowed where women and children were deemed economically unequal to the superior managers, merchants, lawyers, or employers; so that the agreements which they made respecting the price of labor were not contracts between willing buyers and willing sellers. Many other complexities arise with the incoming of large-scale production, collective action, and the cycles of prosperity and depression; and these also are among the variabilities that must be taken into account in the evolutionary application of the basic principle of the willing buyer and willing seller.

A recent writer (O.Lange, in *The Review of Economic Studies,* June, 1935) holds that economic theory does not have within itself a principle of evolution, and must follow Karl Marx in a theory of historical materialism in order to derive a theory of economic evolution. But I reduce Marx to a theory of efficiency measured by man hours as an essential part of economic theory, although usually measured by dollars. And I find economic evolution in the changes in custom, the changes in citizenship, the changes in sovereignty, as well as in technological changes. Lange includes, in his meaning of technique, changes in "organization," which, with me are changes in institutions. The evolutionary principle in the common law comes under Darwin's artificial selection, not his natural selection. It is artificial selection by judges.

This evolutionary principle is possible because lawful economics is itself highly variable though founded, in Anglo-American common law, on the willing-buyer-seller assumption. Not only does it have the variabilities of corporeal, incorporeal, and intangible property, and the variabilities of reasonable and unreasonable values, but also the revolutionary variabilities of communism, fascism, nazism and the gold clause decisions.

12 C. M. & St. P. Ry. Co. *v.* Minnesota, 134 U.S. 418 (1890).

13 By the National Industrial Conference Board, report on *Federal Corporation Income Tax,* Vol. I, pp. 23, 126 (1928).

14 A fiction is introduced by personifying corporations as individuals and giving to them not only the economic rights, liberties, and responsibilities previously attributed to individuals, but also the additional sovereign rights and liberties of collective action, limited liability, and so-called immortality. They are not individuals—they are organized collective action in control of individuals. This personification of collective action ends in the inequality of treating as equals a concerted thousand or hundred thousand stockholders and bankers, acting together as a single person, in dealings with wage earners or farmers of other buyers or sellers, who act separately in their naked individualism of Smith, Bentham, Ricardo, the Austrian economists, the Declaration of Independence.

The statement of this fiction is found in the case of Santa Clara County *v.* So. Pac. R.R. Co., 118 U.S. 394, 396 (1886). The Court said, "One of the points made and discussed at length in the brief of counsel for defendants in error was: Corporations are persons within the meaning of the Fourteenth Amendment." Chief Justice Waite said: "The Court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment forbidding a State to deny to any person… equal protection of the laws applies to corporations. We are all of opinion that it does." See E.S.Corbin, *Twilight of the Supreme Court,* 205 (1934). When the state of Wisconsin started, in 1907, to regulate public utilities it required all of them to take out corporate charters. Many individuals and partnerships convert themselves into corporations for other than technological reasons.

All economic theories distinguish between activity and the objects created by that activity. A familiar instance is "production" and "product." So with institutional economics. The distinction can be fixed by the terms "institution" and "institute." The institution is collective action in control of individual action. The institutes are the products of that control. What are usually named institutions are more accurately named institutes. The institutes are the rights, duties, liberties, even the exposures to the liberty of others, as well as the long economic list of

credits, debts, property, goodwill, legal tender, corporations, and so on. Even the individual of economic theory is not the natural individual of biology and psychology; he is that artifical bundle of institutes known as a legal person, or citizen. He is made such by sovereignty which grants to him the rights and liberties to buy and sell, borrow and lend, hire and hire out, work and not work, on his own free will. Merely as an individual of classical and hedonistic theory he is a factor of production and consumption like a cow or slave. Economic theory should make him a citizen, or member of the institution under whose rules he acts.

This distinction between institutions and institutes will, perhaps, account for a criticism of my *Institutional Economics,* by P.F.Brissenden in *The Nation,* June 26, 1935. Brissenden says that the book "is full of theories of value, transactions, and 'going concerns' but almost empty of institutions." The explanation, I take it, is that he overlooks my definition of institution as "collective action in control of individual action" which I had named a going concern. But the values, transactions, rights, duties, debts, corporation assets, and liabilities, working rules, and so on, expressed quantitatively by measurement in terms of legal tender, are what I should have distin-guished as the various institutes created and enforced by the institutions. Justinian's institutes were drawn up by lawyers selected by him, but it was Justinian himself, at the head of the institution of sovereignty, who proclaimed and enforced them. Economists who reject institutional economics have always been using institutes. It will be seen also that I do not use the word institution as interchangeable with sociology. I mean legal and legalized institutions.

15 Cf. Hans Kelsen, *Allgemeine Staatslehre* (1925).

16 Edw. S.Corwin, *The Constitution and What it means Today,* 105 (4th ed., 1930); Commons, *Legal Foundations of Capitalism,* pp. 333 ff. (1924); see especially majority and minority opinions in Hurtado *v.* California, 110 U.S. 516 (1884).

17 This is the predicament in teaching the Constitution to children in the public schools and in meeting the repeated demand that we "go back to the Constitution." We cannot go back to the written Constitution. We go back to the unwritten constitution. In the case of the institutional economics of reasonable value we go back to the common-law assumption, and its later evolution, of a willing buyer and a willing seller. This is the simplified economic assumption of the unwritten constitution. There are other sources of the unwritten constitution, but I am speaking here of economic valuations by public authorities which the Supreme Court has said are a judicial question. See W.B.Munro, *The Makers of the Unwritten Constitution* (1930); C.E.Merriam, *The Written Constitution and the Unwritten Attitude* (1931); R.L. Mott, *Due Process of Law* (1926); E.S.Corwin, *The Constitution and What it means Today* (4th ed., 1930). The gold clause decisions were a revolutionary change in the unwritten constitution as previously decided in the legal tender cases. They changed the meanings of "obligation of contracts" and of value, by transferring from creditors to debtors millions of dollars which had been willingly agreed upon at the time when the debts were contracted. But similar judicial revolutions have occurred in the meanings of other words in the unwritten constitution. See Commons, *Legal Foundations of Capitalism* and *Institutional Economics* on the Court's changes in the constitutional meanings of property, liberty, person, and due process of law.

It is upon the ground of the primary assumption of willing buyer and willing seller in the unwritten constitution that I argue for a mandate of Congress for a reasonable stabilization of prices as far as practicable by the Federal Reserve system. The gold clause decisions are an evolution from the legal tender cases. They leave no fixed weight of gold as the measure of value. They assert the validity of legal tender paper throughout the nation as fulfilling the constitutional obligations of contract. The stabilization of legal tender prices is the stabilization of creditor-debtor relations. If such a law were enacted by Congress its constitutionality, as construed by the Court, would be a further evolution of the unwritten constitution.

This bears on the debated point of judge-made law. The judges do not actually make law. They decide particular disputes. Then it is expected that they will decide similar disputes in a similar way, and so, what is the use of bringing up the same point again? This is not so much the way

in which law is made as it is the way in which custom is made. A description of the evolution of custom, in Anglo-American law, is the change in habits due to change in expectations of what the courts will do in deciding conflicts of interest. This is more appropriately named judge-made custom instead of judge-made law. In America, this evolution of judge-made custom in economic affairs is the growth of the unwritten economic constitution.

38
CAPACITY TO PRODUCE, CAPACITY TO CONSUME, CAPACITY TO PAY DEBTS

American Economic Review 27 (December 1937):680–697.

Characteristic of post-war economics is an avowal of public purpose as a goal toward which the theories are directed, and of experiment as the means of realizing that purpose; Investigations start with the assumption of a "disease" of capitalism, then follow with a comparison of remedies proposed elsewhere, and end with the author's proposed remedy and experiment designed to reach the goal of an ideal democracy. Moulton invites large business establishments to quit their policy of maintaining prices and to join with the Brookings Institution in making experiments of reducing prices in order that the abandoned goal of classical economics may be reached by benefiting consumers who are "the whole of society." Irving Fisher looked forward to an experiment announced in 1932 by the Bank of Sweden of raising and stabilizing domestic prices which he thought would remedy "the private profits disease." Reports of progress are being made on the Swedish experiment. The contrasted theories started several years ago from opposite poles of the same credit-debit relation, Moulton with credits, Fisher with debits. Moulton's credit turns out to play a passive role, consistent with the classical economics of production and consumption. The active role of credit is played by central banks of discount, and turns on "commitments" made by everybody for the unknown future for which statistics are not yet available for investigation.

If one compares the two volumes, *Formation of Capital* and *Income and Economic Progress,*[1] written by Harold G.Moulton, with the volume on *Booms and Depressions,* published in 1932 by Irving Fisher, or the volume on general monetary and credit theory, published in 1936 by John Maynard Keynes,[2] one seems to be living in two different economic worlds. Yet they are the same world tied together as tight as a credit and its equal debit. Moulton has little to say about debt. His modern industry is conducted on credit. Fisher and Keynes are concerned with the debts which create equal credits.

The difference in emphasis leads to opposite conclusions on public policy. Moulton's policy looks to gradual price reductions over a period of time. Fisher and Keynes look to day-by-day emergencies that require even reversals of policy in preventing at one time a general fall of prices, and, at another time, a general rise of prices.

Each diverges from classical and neo-classical theories in several respects. First, is an avowed ethical purpose typical of post-war reconstruction of economic theory, where such purposes had been disavowed as unscientific. These avowals lead to proposed future experiments designed to test the workability of the purposes. The investigations, which prepare for the experiments, follow the example of the science of medicine, if that may be called a science which directs its investigations toward the optimum of human health and longevity. Moulton makes what he calls "diagnosis of certain failures of capitalism," while Fisher's is a diagnosis of the same capitalism as the "private profits disease," or the "debt disease." Each investigator then makes comparison of several proposed remedies in order to make selection, with his own modifications, of what he deems the best promising remedy for the disease. The remedy is avowedly experimental. Moulton looks forward to future experiments of voluntary price-reducing by individual firms; and Fisher, in 1932, looked forward to an experiment then recently announced by the Bank of Sweden in adopting a general domestic price-stabilization policy.[3]

The latter experiment, in comparison with a similar experiment by the Bank of England, has later been reported upon by Mr Bertil Ohlin; and important detailed investigations of the Swedish experiment were afterwards made by Mr Richard A.Lester, of Princeton University, and by Mr Brinley Thomas, of the London School of Economics.[4]

Another divergence is from the classical assumption of continuous full employment of all the factors contributing to the production of wealth. Upon such a simplified assumption it had followed that equilibrium of all the factors among themselves would automatically be maintained by rising prices of those factors temporarily scarce and falling prices of those temporarily oversupplied. The only activity that would need to be considered in human transactions would be that of substitution—substituting factors whose prices were falling for those whose prices were relatively rising, thus restoring equilibrium without leaving any of them unemployed. But when the assumption of continuous full employment is tested by investigations which show that all of the factors are sometimes idle or slowed down at the same time, then the investigator formulates another hypothesis diverging from, but not eliminating, the principle of substitution.

The extensive and important investigations made by the Brookings Institution lead Moulton to diverge from another simplified classical assumption, that of individual action, and to introduce the complexities of collective action controlling more or less the mobility and substitutions of individual action. He says:

> It is evident from the analysis which we have been making that the system of wealth production and distribution has not been working in the manner that had been expected. The method of continuously expanding markets through a persistent reduction of prices as efficiency increases has in considerable measure ceased to operate. Price stabilization policies have in many lines come to stand in the way of a dissemination of the benefits of progress, and have therefore tended to nullify the results of

> technological advance. This unexpected outcome of the evolution of the capitalistic system obviously requires explanation…. Interferences with the competitive price system have occurred as a result of at least three major types of business organization. The first is the unified monopoly of industrial combination, by means of which the prices of particular commodities are controlled by a single management. The second is the cartel, a "collective monopoly," under which there is group control of production with a view to stabilizing prices in a given industry. The third is the trade association, which seeks usually through informal cooperation, to stabilize certain conditions within particular industries, without interfering with the control of production. Such associations are of various types and the degree to which they may influence prices varies widely. Unified monopolies, private and public, exist in all countries; the cartel is found chiefly in Europe; and the trade association is essentially an American development which has flowered in the post-war period.[5]

To which he adds, in other places, the collective action of labor organizations to the disadvantage of "unorganized workers, clerical and professional classes, the farm population, etc."[6] He might properly have added, still further, the collective action, or the "pressure groups" in politics, of these previously unorganized classes.

These two divergencies from classical doctrines, based, as they are, on investigations of collective action and simultaneous unemployment, are naturally enough not given weight by such critics of Moulton as adhere to the assumptions of mobility, individual action and automatic equilibrium.[7]

But there is another divergence from classical doctrine to which Moulton had brilliantly contributed as early as the year 1918,[8] and which he incorporates in these volumes. The classical economists, followed by the communists, tacitly eliminated money and credit when they treated gold and silver like other commodities whose value was determined in the past by the labor costs of production. They were concerned with the increasing technological efficiency of the capitalistic system, and had no place for either the legal tender quality of metallic or paper money or the part played by "credit currency." When John Stuart Mill displaced labor-cost by money-cost he explained credit as optimism or pessimism supplemented by the misuse of accommodation bills at that time. But modern business is conducted on the bookkeeping of credit and debit. A world war is financed by credit. Moulton corrects the classical doctrine by introducing the "credit structure" into the "formation of capital."[9]

Yet his concept of credit still adheres to the classical elimination of credit in that it plays what is really a passive role in the economic world. The technological and marketing processes play the active role. The active role of credit, forced to the front of economic policy by the impounding of gold, is regulated by governments through central banks of issue and discount, through open-market operations, through raising and lowering the foreign-exchange rates, through expanding and contracting note issues, through raising and lowering the price of gold bullion as proposed by Fisher in 1912, through raising and lowering, in America since 1935, the reserve requirements of commercial banks, and, more recently, by an equalization arrangement of currencies between the governments of America, France and England. This regulation of the active

role is set forth, in part, by Ohlin, in the article referred to. He says, contrary to Moulton's price-reducing policy:

> Sweden does not desire a heavy rise in prices, as it would probably be accompanied by a condition tantamount to an exaggerated boom. Under such circumstances the Bank of Sweden would undoubtedly lower the sterling rate in order to weaken the price-raising tendencies emanating from outside…. If, on the other hand, a substantial fall of the price level were to occur in England, the Bank of Sweden might be expected to raise the sterling rate in order to Protect Sweden from an undesirable fall in prices. Sweden will maintain her currency's firm association with the £-sterling only so long as England's monetary policy keeps a course that is satisfactory to Swedish economic life…. The primary aim of Swedish monetary policy is to make prices attain such a level as will enable production and trade at home to prosper. The stable sterling rate is important, it is true, but it is only of secondary importance. In the event of Sweden's being unable to achieve both these objects simultaneously and compelled to give up one of them, the stability of the £-sterling rate would have to go…. The linking of the krona to sterling is due mainly to the fact that England's monetary policy aims at preventing further deflation and bringing about a moderate rise in wholesale prices. This is exactly what Sweden had already at an early stage set up as her goal, it being fully realized that this was the only policy that could rapidly create the conditions essential for an economic revival. What could be more natural than that Sweden should maintain a fixed sterling rate so long as England pursues a similar policy? It affords Swedish foreign trade the advantage of a stabilized quotation for that exchange in which the bulk of its transactions are settled.

Moulton's injection of "the credit structure" between producers and consumers reveals a discrepancy concealed in the theory of savings and consumption. For the isolated individual, who is both producer and consumer, savings are increased only by reducing consumption. As one increases, the other diminishes. But Moulton's investigations show that with the prevalence of credit, both savings and consumption increase and diminish together. The explanation, in part, is that savings are invested in "ownership" rather than in production. He says:

> At the present stage in the economic evolution of the United States, the problem of balance between consumption and saving is thus entirely different from what it was in earlier times. Instead of scarcity of funds for the needs of business enterprise, there tends to be an excessive supply of available investment money, which is productive not of new capital goods but of financial maladjustments. The primary need at this stage in our economic history is a larger flow of funds through consumptive channels rather than more abundant savings.

He goes on to specify the diversion of excess savings:

> What became of money savings which did not eventuate in new plant and equipment? The answer is that they were utilized in purchasing the ownership (stock) of existing corporations, thereby bidding up the prices of outstanding securities. Instead of producing new plant and equipment they raised the prices of that already built. The process is identical with that of commercial inflation. As the prices of securities rise a greater volume of savings is required to purchase a given number of shares of stock, just as when the prices of commodities rise a greater amount of expenditure is necessary to purchase the same volume of goods.[10]

What Moulton says above as to "purchasing ownership" is as true regarding commodities as it is regarding plant and equipment. Prices in both cases are paid, not for physical products, but for their ownership. This significance of acquisition and alienation of ownership was concealed in a double meaning of the traditional term "commodity," which means both a physical product and the ownership of the product. Before either production or consumption can be carried on, lawful ownership must be acquired. The acquisition of ownership signifies a debt incurred in consideration of alienation of ownership by the other party to the transaction. The other party acquires a credit, which is simply ownership of the debt.

Moulton's "excess savings," then, as is true of all savings, are "invested," first, in ownership of bankers' debts. They are then reinvested in two directions which may not be contemporaneous. "In the prosperity period of the twenties," he says, excess savings were invested in the ownership of plant and equipment, thus raising the prices of securities. But in that period "no appreciable rise in commodity prices occurred at any time. In fact, the level of wholesale prices was slightly higher in 1924 than it was in 1929."[11] Contrasted with this period were the preceding short periods, 1919–1920 and 1923–1924, when excess savings were invested in the ownership of commodities, thus raising commodity prices.

We know the communistic solution of this diversion of excess savings into ownership instead of production. The wealthier classes, who invest excess savings in ownership, ate expropriated and the state itself does the saving by determining the quantity of output and fixing the selling prices to consumers at a high enough level, and the buying prices paid to the same individuals as producers at a low enough level to yield forced savings, by reducing consumption, which the state then converts directly into capital formation and commodity production. Something similar is occurring in fascistic and nazistic countries, while in all of them forced savings go increasingly into militaristic capital formation. Other countries increasingly obtain forced savings by taxation, and corporations must maintain selling prices high enough and buying prices low enough to force and extract savings from others for payment of their own costs, debts, taxes, extensions and dividends.

While excess savings can be made to disappear in the last extreme case of communistic ownership in control of both prices and output, yet in parliamentary countries, with their freedom of savings, of consumption and of investment, they are the

source of the equilibrium waves of prosperity and depression which are sought to be prevented by credit regulation over the entire field of free enterprise.

The passive role of credit is a passive role of the equal debt. The "flow of funds" to finance commodities, plant and equipment is an equal flow of debt owed by the bank customers who get the funds. It is not a "flow"; it is an active joint creation by contract of credits and debts to be liquidated by payments.

The passive role of credit and debt is a passive role of even savings, consumption and investment. These are passive in that they are the statistical compilations made possible *after* the event, whereas the active role is the events themselves which are the preceding decisions made at successive points of time to save, to consume, to invest. The statistician has nothing to go upon until the overt act has occurred. But the decisions themselves, whether deliberate or impetuous, are preceded by a brief or prolonged period of uncertainty, of weighing alternatives, of hesitation and doubt, of persuasion or even pressure by others; They are made in view of an immediate or remote future which may be vivid or dim.

Savings are not hoarded, except perhaps as metallic or paper money. They are credits granted to debtors. If the savings are deposited in a bank, the banker is the debtor. The bank is not a "manufactory of credit,"[12] an analogy descended from classical theories of production. The banker is a negotiator of credit currency in the form of his own bank debts. And he does the negotiating in the process of determining, with his customers, the limits in amount and duration of their debts which thereupon he actually buys by credits and sells by debits to their accounts.

The failure to take account of these legal creditor-debtor contracts is expressed by Keynes as the "optical illusion" that credit at the bank is somehow a one-sided affair in which the creditor "deposits" something for safe keeping.[13] But his deposit is a two-sided transaction of buyer and seller, made possible by the legal invention of negotiability of debts. This two-sidedness, says Keynes, is true whether the activity is that of spending or of saving. We may add, even the pocket-money or lawful "money in circulation," which is carried about, is obtained from a bank and returned to a bank only because somebody, say an employer, can draw it out on payday. And the employer is often worried as to how he will get that money when his debts to wage-earners come due. So that 100 percent of all money is directly or indirectly bank credit.

These and others similar are the activity meanings of savings, of investment, and of, not consumption but purchases for consumption. Forecasts of time are of their essence. To appreciate them the economist cannot rely on statistics or logical analysis of what has happened in the past. He must have imagination and sympathy which will place him in advance of available statistics at the time-points when decisions by banks and customers must be made that commit them to the unknown future. They are not, indeed, forgotten or overlooked. They are simply neglected because capacity to produce and capacity to consume are not linked up with capacity to pay.

This lack of imagination relegates to a passive role even profit itself. Although profit is recognized as the dynamic factor that stimulates initiative in capitalistic economics, yet the statistical limits of investigation reduce it to a passive role, along with interest, wages and rent. The rate of profit is calculated by Moulton from the statistics as a ratio to "capitalization," and it ranges (before corporation tax) from a high of 9.5 percent in 1923 to a low of *minus* 4.7 percent in 1932.[14] But the supporting statistics are compiled *after*

the end of the year or dividend period, when all of the transactions of the preceding period have become known. This is not the problem that confronts the profit-seeker. He must make his decisions *before* there are any statistics. His decisions take the form of "commitments," emphasized often by business men as neglected by economists, neglected because there are as yet no statistics, at the time of commitment, of what will happen in the future.

Commitments, analyzed in meticulous detail as to the essentials, are legal obligations of two kinds, debts of payment and debts of performance. As a buyer the business man commits himself to future payment for services performed or to be performed; as a seller he is committed to future performance of delivery of a product manufactured or to be manufactured. Reciprocally, the party with whom he negotiates commits himself to delivery of the product as a seller and to payment for the product as a buyer. The debts of payment are bought by a banker, if approved by him, who thus commits himself to furnishing "cash," which is deposit-currency, in the shape of his own debts payable to sellers or their assignees on demand. All of them are tied together by their bookkeeping records of credit and debit, which are evidence of their legal commitments.

In addition, with modern central bank systems, the individual bankers are subject to a central regulation according to the various working rules above mentioned as pertaining to the active role of credit.

Bringing together those several considerations in the time-sequence of looking to the future, there is, first, the universal business practice of accepting bank checks in liquidation of debts which, when drawn by solvent depositors on solvent banks, is a custom practically as compulsory as the acceptance of legal tender metallic or paper money in a suit at law; second, the working rules of the central bank, known directly in advance by the commercial bankers who are governed by them, and thus indirectly known by their customers; third, the "state of confidence," which, if properly interpreted and measured, is the velocity of debits to individual accounts; fourth, the credit and debit commitments of these bankers and their customers, which are the active process of credit formation; fifth, the alienation and acquisition, by operation of law, of ownership of whatever securities or commodities are bought and sold; sixth, the physical control and labor management of materials in process of manufacture, made possible by the preceding transfers of ownership.

Within this changing frame of reference the profit-seeker must, in each transaction, decide whether to buy or not to buy, how much or how little to buy and the prices, whether to sell or not and how much, whether to incur debts of payment or performance and how much, whether to grant or not grant credit and how much to purchasers or to borrowers at the bank, and so on. Each commitment binds him to the exigencies and risks of the future for which there are no statistics. There are forecasts, guesses, probabilities, hunches, intuitions, based indeed on past experience or habit. There are the day-to-day market reports, the state of confidence, or lack of confidence, in his own mind or derived from what he gets out of the minds of others. There are the professional forecasters, who may or may not know much about his particular business. When he buys materials or labor from day to day he commits himself to maintaining or enlarging output which may or may not be sold at profitable prices. When he borrows and mortgages his business on long-term investments in plant-extensions, in equipment, in inventories, he must look ahead into the diminishingly vivid future as to prices and quantities which purchasers will

pay for materials and labor. He may find, when the statistics are eventually compiled, that he has made serious mistakes in his commitments. He has been accumulating debts, short-term and long-term, for purposes of production, and he runs the further risks of the entire credit structure as to whether he can or cannot convert his assets into cash when the debts come due, or whether the cash will purchase more or less of the commodities which he must buy. The academic mind, the statistician, can then tell him what he ought to have done. He ought to have reduced prices, increased his output, benefited humanity. But if the academician or statistician had been "up against it" when the decisions and commitments were made and the responsibilities were assumed he probably would now be bankrupt too.

Still further, what the profit-seeker has to go upon in making his commitments for the future is not even Moulton's above-mentioned ratio of profits to "capitalization," but is the much narrower ratio of profits to immediate or nearby sales of his product at current prices. These are statistically compiled by years for all manufacturing establishments as "gross sales," meaning gross-sales-income or expected assets.

And profit itself must be reduced to "pure profit" by deducting from Moulton's calculation of "aggregate net profit," not only intercorporate dividends but also taxes, interest, and any other liabilities. The profit-seeker is always "trading on the equity," whether of securities or commodities, which is the narrow margin for profit after deducting all debts and liabilities, whether debts to the state (taxes), or any other debts or obligations, known usually as "overhead costs" to be added to operating costs which are also debts. Calculated in this way, where Moulton arrives, for the year 1923, at a rate of 9.5 percent on "capitalization," I arrive at the much narrower profit margin of only 1.9 percent as the ratio of "pure profit" to gross sales. Where he calculates, for the year 1925, a rate of net profit to capitalization at 9 percent, I find a profit-loss on gross sales of one-half of one per cent (−0.5). Again, where he finds, for 1929, a ratio of 9.2 percent profit, I find only 3 percent profit on sales; and so on for the various years from 1922 to 1929, where we use the same official *Statistics of Income* of the Treasury Department.[15]

The explanation of these discrepancies is in the "rate of turnover," which is the ratio of gross sales to nominal capitalization. If the par "capital" is $200 million and the gross sales a billion dollars during the year then a margin of 2 percent on sales would yield 10 percent on capital stock, or a loss on sales might mean a "profitless prosperity," made palatable to stockholders by "window dressing," or by the "profit cushion" of dividends deferred from prosperous times. This cushion, however, did not come into the official statistics of income until after the year 1920.[16]

But even these statistics of gross sales are not known until they are compiled *after* the end of the preceding fiscal period. Consequently the transactions themselves, which are the commitments to the unknown future, are doubly concealed by the statistical totals of all establishments merged into a grand total for the nation, and by the lesser totals for each establishment not known until its accounts of the preceding period are audited. It is in the millions of these particular transactions that the profit motive, which creates credit currency, is actively at work.

These calculations are usually treated as risk. But, again, even the computations of risk are statistically possible only after the risks have been taken. They can then be merged into an average risk of some kind which is good enough for insurable risks. But each transaction is its own particular risk. It differs from every other risk. The profit-seeker is

not up against the risks of other people or even against his own risks in other transactions. In order to work out a theory of risk with mathematical accuracy the individual is "supposed" to know the future. This is good enough for logical analysis but is remote from reality.

Indeed, risk-taking in each transaction is the focus of a theory of credit currency. It is the strategic factor that makes a theory of credit regulation prior in time and first in importance. Ricardo's quantity theory of money did not apply to credit formation. It applied to metallic and paper money. It placed causation in the past, whereas in human affairs causation is risk-taking for the future. The expanding or contracting quantity of money has, indeed, something to do with the "state of confidence" regarding the future; but even more influential, in recent times, are the working rules of central banks. Too easily have monetary theorists incorporated bank debts into Ricardo's quantity theory of money. But, as is well known and often set forth since the bimetallic controversy, the volume of bank debts expands and contracts independently of and far more excessively than the volume of metallic or paper money. Its "volume" is not properly a "quantity" as contemplated in the usual theories of demand and supply—it is the activity of bargaining which creates, liquidates and recreates purchasing power. The usual statistics of total bank deposits make them appear like an expanding and contracting quantity, similar to quantities of metallic or paper money, and thus conceal the fact that, unlike money, they are destroyed every few days or weeks and then new ones may or may not be negotiated to take their place as purchasing power, determined by the expectations of profit.

It is this active role of the profit motive in creating and recreating the credit instruments of its own purchasing power that distinguishes the policies of the price-stabilization school of economists and marks the difference between the seemingly two worlds of the classical tradition and the debt-paying tradition. Credit regulation in America has already reached into almost every detail of the private banking business. No other business man is entitled to complain more strenuously than the banker against governmental interference. This public control is coming to be more or less guided with reference to its effects on the general levels of security and commodity prices. In Sweden it is avowedly guided by its effects on domestic commodity prices.

The Swedish policy continues to be experimental and will doubtless require modifications with further experience. But, as far as it goes, it shows that domestic price-stabilization is administratively feasible, not because Sweden is small and separate from international price movements, but because the government's central bank has begun to guide its policy upon theories of credit currency.

These theories began with the older economists, Wicksell in 1899, and then Davidson and Cassel, who, however, retained vestiges of the traditional theories. But, eventually, at the hands of the younger economists, Myrdahl, Lindahl and Ohlin,[17] it emerged as a pure profit theory of credit negotiations. The practical men in charge of the central bank, as is usually the case, took over piecemeal the theories as a series of emergency measures in order to meet new conditions confronting them. They made stabilization of consumers' retail prices their goal, thus permitting wholesale prices to rise gradually during the present emergency, while the cost of living remained "practically stationary."

During the two years after the abandonment, in 1931, of the gold standard, the purpose of the experiment in gradually raising the wholesale price level was not accomplished, for various reasons which Ohlin mentions. But after the United States left the former gold

standard, beginning with June, 1933, and continuing to the same period in 1935, industrial production in Great Britain increased 19½ percent and in Sweden 38½ percent; but in the gold standard countries of France and Holland production decreased respectively 17 and 5½ percent. These results were induced by the movement of the wholesale price level which had risen, at the end of 1935, about 7 percent in Great Britain and Sweden but had fallen 30 percent in France and to a lesser extent in other gold countries. Retail prices and the cost of living continued to fall in the gold countries. As to foreign trade, the chief difference between the sterling and gold countries "is that the former have had to ship abroad a relatively larger quantity of goods without being paid any more for them." Ohlin concluded, in effect, that the general price-raising policy of credit control is strategic and that the rate of production is complementary.

Ohlin's correlation of prices and output is comparable to ratios derived from statistics cited by Moulton for the United States.[18] In the prosperity period, 1924 to 1929, when stock prices were rising inordinately, commodity prices fell about 2 percent, yet the output of consumption goods increased about 14 percent and the output of capital goods increased about 16 percent. Conversely, in the preceding period, 1922 to 1924, when commodity prices rose about 1½ percent, the output of both consumption goods and capital goods increased about 20 percent. And in the succeeding period, 1929 to 1932, when stock prices collapsed and the commodity price level fell about 30 percent, the output of consumption goods declined about 50 percent and the output of capital goods declined about 60 percent.

From these statistics for America it is difficult to decide which is the strategic factor, whether credit or production, because no conscious experiment was made to control either of them with reference to prices. Moulton makes note that in periods of recovery the increase in volume of output is more significant and important than the rise of prices. Such a conclusion is the foundation of the communistic policy of controlling and rationing output, as well as of those who look to non-credit factors. But in free countries the theory that general price stabilization or general price-raising through credit regulation is the strategic factor, and the desired increase of output is complementary, can be validated only by experiments which follow the adoption of that policy.

Here the time sequence and its accompanying theory that cause precedes effect are irrelevant, because the adoption and publicity of such a policy leads private enterprise to anticipate it by increasing output in view of the expected carrying out of the policy of a general rise or stabilization of prices. Lester notes this principle in the special case where "moral suasion" induces the private banks to restrict the expansion of credit even though expansion might be immediately profitable to them. If so, then other private enterprises which negotiate with the banks would also anticipate the positive acts of the central bank in preventing an exaggerated boom, although it might be unprofitable to them individually to restrict output at that time. It is a special case of the risks of futurity in human affairs, and whether it operates, or to what extent it operates, can be discovered only after the experiment itself has been made.

Even so, these statistics and correlations are derived from what happened in the past. They could not be known for sure at the time when policies were decided upon and commitments were made for the future, either by governments or individuals. Investigations of past experience and past experiments are of course common-sense

methods of predicting the future. But the future still remains uncertain. Its uncertainty is the field of credit currency, distinguished from the field of metallic or paper money.

A further assumption follows from the passive role of credit and debt, the tacit assumption of a constant or stable purchasing power of money or credit. Since credit is always present in modern business calculations it cannot be excluded. It can be eliminated hypothetically by the familiar device of "supposing" that its influence is "constant." This was the classical method, often employed by Ricardo, and the very proper method in reaching the simplified assumptions" of major premises in all deductive reasoning. The consequence, if left at that, is an unreal world. The purpose of experiment is often to put back into the equation the omitted variable, which, in turn, has itself been simplified by supposing that all factors other than itself are constant.

Connected with the passive role of credit is indifference to the active human effort of meeting emergencies. The efforts of farmers, through governmental leadership, to restore their purchasing power in terms of industrial products, is met by the argument, "Whatever temporary benefits might thus be conferred, it is a method which, if pursued as a long-run policy, can result only in stationary or declining standards of living."[19] But the method referred to was avowedly an emergency measure, with provision for its termination when statistics might show that the emergency had passed. Contrasted with this is the conscious policy, referred to by Ohlin, of meeting both big and little national emergencies by temporary measures in advance. An "exaggerated boom" of rising prices is to be prevented as well as an "undesirable fall in prices."

The passive role of credit is likewise the *laissez-faire* role of the state. It is the simplified assumption that the state is "neutral." It ends in the rather pathetic appeal to big business voluntarily to reduce prices. The pure logic of the argument is inescapable. A greater aggregate profit may often be made for an individual firm by enlarging the output at reduced prices than by restricting the output at higher prices. There have been examples of this enlightened policy, and Moulton refers to them as well known. On the other hand, some of the greatest corporations, the railway companies, had to be compelled by government to reduce rates, and then were surprised by the resulting increase in profit. The state and federal governments went further and, quite contrary to the classical passive theories, they restricted the right of investment by requiring certificates of convenience and necessity before extensions of "capital formation" were permitted. In the competitive manufacturing field, as in the monopolistic railway field, it was obviously the fear of price-cutting that brought about the mergers, consolidations, holding companies, trade associations whose policies of price-maintenance are condemned by Moulton. Similar policies were attempted but were unconstitutional in the experiments of the National Industrial Recovery and the Agricultural Adjustment legislation. The Securities Exchange Commission is a similar venture, not yet unconstitutional. Apparently in all fields the business men must actively be taught their own business by government through compulsory school attendance. This education includes the field of credit regulation. The difference is that in the latter field the regulation is general, directed to the prices charged in all industries, while in the former the regulation is specialized. The one, as practised in the more recent emergency by Sweden and England, is a general price-raising policy; the other, as advocated by Moulton and the classical economists, is particular price-reducing policies for individual establishments or industries over a long-run period of time.

How far into the future these general price-raising policies shall continue is left for the emergencies of the future. They are evidently efforts to recover from depression, and, when the recovery is reached by restoring industry to full capacity and thereby absorbing the unemployed, a general price-stabilization policy would be accomplished by the same administrative methods of day-to-day credit regulation. But that is left to be decided when the time comes.

For the reason that purpose or policy looks to the future, for which statistics are not yet available, neither the facts nor the "rigid economic analysis" of the facts lead to any logical or inevitable conclusion as to what to do now in contemplation of the uncertain future. This is a predicament for both the price-stabilization and the price-reduction policies. Each must turn to a different mental process, an emotional rather than intellectual process, which may be named variously as good judgment, wisdom, argumentation, pleading, appeals to hope or fear. Here the method of reasoning is that of a comparison of different proposed policies by weighing their advantages and disadvantages. Moulton turns from his "diagnosis" to a comparison of remedies or "lines of progress" which have been proposed elsewhere, such as taxation and public enterprise, raising money wages, profit-sharing, the antagonistic policies of wage-earners and farmers, and concludes with his own "democratic ideal" of "distributing income through price reductions."[20] Keynes's "rigid causal analysis" leads him to the alternative policies of "allowing prices to fall slowly with the progress of technique and equipment whilst keeping wages stable, or allowing wages to rise slowly whilst keeping prices stable." He then turns from logic to ethics and concludes that "on the whole" he prefers the price-stabilization policy, but "no essential point of principle is involved."[21] Fisher compares different "palliatives" for the "debt disease" and finally settles upon stabilization of the general purchasing power of the dollar as "the remedy."[22] Ohlin discusses the monetary policy of the Bank of Sweden as what Sweden "desires" or "does not desire."

The predicament arises, in part, from the above-mentioned double meaning of a commodity—its price and its quantity—and in part from looking into the future. Which of the two meanings is the strategic one and which is complementary? Shall output be controlled to prevent over-production and under-production, or shall prices be controlled and output be left to follow as it may? We know that in private industry both controls are practised. And we know, from monopolistic public utility regulation, that when the state fixes prices it also must require the corporation to render service at those prices. But if this control of output is carried over to competitive industries, very little scope is left to private initiative, as is already the case in the regulation of public utilities privately owned, where private initiative turns from production to stock ownership. In the extreme case of communism both prices and output are controlled by the state.

Since purpose or policy looks to the future, it is the realm of ethics as well as economics. The classical economists, followed by Moulton, took for granted that the "whole of society" was the consumers. Production of wealth is, or should be, directed toward the consumer's satisfaction of wants. What the consumers want is abundance of products at low prices. The appeal is universal. Everybody is a consumer, from paupers to millionaires. But producers are divided into innumerable special interests each selfishly working against consumers by maintaining prices and restricting output. Yet it is noticeable that each consumer wants to maintain high prices for the products which he sells and low prices for the products which he buys.

The price-stabilization, or general price-raising, school definitely takes the standpoint of producers and, in particular, of that legal end of the productive process where duties and responsibilities must be accepted and commitments must be made in order to enter and continue in business by making a margin of profit on sales. But it takes the standpoint of *all* profit-receivers, not of individuals or firms. All business men, whether in mass-production units or in petty units, must become debtors to everybody whom they enlist in production and marketing—to laborers for past services, to investors for past savings, to land owners for rents, to governments for taxes. The debts are enforceable at law, carrying penalties of insolvency, foreclosure, bankruptcy, receivership. All other classes prefer to deal with solvent debtors, even though they are the disliked monoplists. Under the capitalistic system that is the only way for them to get a living or get employment and thereby get capacity to consume. It is not a matter of appeal to public spirit. When the business man gets scared about insolvency he slashes right and left regardless of others. In periods of prosperity, with rising prices and expansion of sales, he may be appealed to by labor unions and charities. The policy of gradually raising the general price level yields what our Francis A.Walker, seventy years ago, named a "fillip to industry," by which was meant a fillip to profits.'[23] It gradually enlarges the business man's capacity to pay debts. Ohlin's exposition shows it experimentally at work on a credit basis.

The term "price stabilization," as Moulton rightly explains, has more than one connotation.[24] It may have the meaning, which he uses, of price-maintenance of *particular* commodities, distinguishable as his monopolistic or privileged price stabilization. It may also mean "efforts to control the general level of prices through the manipulation of money and credit," distinguishable as *average,* or national, or even international price stabilization. Such is the policy of the Bank of Sweden, but this kind of stabilization is excluded from the investigations made by the Brookings Institution.

Yes, the general price-stabilization policy and Moulton's price-reducing policy are not inconsistent when once the principle of relativity is brought into the investigation. The one is directed toward an average of prices, the other toward particular prices of individual firms. Individual prices may rise or fall relative to the average, while the average rises or falls or is stabilized. A statistical construction of averages is officially set up by the Bank of Sweden as a kind of thermometer to guide the management in its credit regulation. It has the advantage that it does not interfere with individuals, whether monopolistic or competitive, in their transactions. An "average" does not exist except as a mental tool for investigating certain similarities, or as a working rule of concerted action in regulating certain similar aspects of individual action. If individuals or firms are dealt with, then individual inducements are used, including Moulton's plea addressed to monopolistic enterprises voluntarily to reduce their prices relative to the average of all prices.

Their self-interest may be appealed to, with a disavowal of ethical purpose, because the ethical relations proper have been taken over by the state, as in other cases of justice and ethics where individual appeals are inadequate. This principle applies also to state and federal regulation of public utilities, or of market commissions, or of industrial commissions and the like, where government endeavors to apply rules of "reasonable value" or "fair competition" as an ethical ideal in default of successful appeal to the self-interest of individuals. The latter do not lose their place in their particular fields when the

policy of average price-stabilization by credit regulation is made to apply to the more general field of all economic enterprises.

In weighing different policies by argument and pleading rather than by rigid causal analysis Moulton properly enough discards the arguments of capitalistic economists who look to the heavy industries for recovery. A similar discard is made of the arguments of leaders of labor unions who look to the wage-raising efforts of organized labor as the means of recovery by increasing the purchasing power of labor. Each of these arguments is shown to be partial and inadequate for recovery.

But the conclusion also contradicts the price-reducing policy. It, too, is partial and applies avowedly only to those firms which by mass-production have become capable of reducing prices. The smaller firms and independent farmers are not mass-producers and can, to a much less degree if at all, reduce prices and survive. They are overlooked in his "democratic ideal." He says:

> The elaborately industrialized system known as "mass production" marks the highest level attained under man's productive programs. But we cannot have the economics of mass production save in an economy of mass consumption. Each is the condition of the other…. To seek the acceleration of economic progress by means of price reductions is not to attack the system of private capitalism but rather to return to the very logic upon which the system was justified and extolled by both lay and professional students of the economic process when the system was assuming its present general character. The basic economic policy which we are enunciating does, however, definitely attack what we regard as a serious abuse of the profits system and the institutions of private capital which have grown up in modern times.[25]

The appeal is supported by past experiments of "the more acute minds within the ranks of business leadership," who have perceived that only by acting in conformity with price-reducing policies "can they assure the longtime success and growth of their own companies as well as minister to general well-being." The general principle on which the appeal is made is in the argument that

> …had the volume of sales been expanded as a result of price reductions, unit costs would have been reduced and profits might well have been larger. The business manager who progressively reduces selling prices as technological improvements are made need have no concern over the long-run trend of profits. The history of business enterprise shows that under such conditions profits usually take care of themselves. Even if profits should not actually increase, a contribution is nevertheless made through the expansion of wealth production toward raising the level of material well-being—which is the ultimate purpose of an economic system.[26]

Yet this democratic ideal does not, he contends, "inject ethical values or political ideals into an economic problem." Apparently he has a double meaning of ethics, for he goes

on, "The underlying purpose of business is to serve the people; indeed only as it serves people can it serve its own best interests."[27]

This ultimate ideal of service to others is a purpose widely accepted in modern "business ethics" and calls for investigation. It was investigated by Adam Smith but excluded by him from classical economics in his well-known conclusion, "I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it." Moulton, nevertheless, proposes to persuade them to it.

But there are limits to price-reducing policies. They are made feasible, to a limited extent, by enlarging the output of individual firms through mass production. There is evidence that this is being extended to agriculture and retail business. The consequence is that independent small producers are converted into wage-earners or left unemployed. Mass production results in mass strikes. If extended further in agriculture the independent family farmers become employees or tenants of large mass-producing or mass-marketing units.

How far in these directions the price-reducing policies shall be permitted to go depends on the kind of government or the kind of business men or laboring men in control at the time. It may be, as in Sweden, the substitution of an agrarian party and a labor party for the older political parties; or, as in Russia, a single labor party; or, as in Italy and Germany, a party of the middle classes; or, as in a *laissez-faire* government contemplated by Moulton, the successive monopolization of industries controlled by large capitalists who prevent further price-reducing by their price-maintenance policies.

On the other hand the average price-raising or price-stabilizing policy, described by Ohlin and advocated by the credit-regulating economists, is a policy preserving the small independent producers, whereas the price-reducing policies contemplate with indifference their reduction to the status of employees in the interest of mass-production efficiency. The preservation of small independent producers is also a democratic ideal.

NOTES

1 Concluding volumes of the series, *America's Capacity to Produce, America's Capacity to Consume, The Formation of Capital, Income and Economic Progress,* The Brookings Institution (1934, 1935).

2 Irving Fisher, *Booms and Depressions* (1932). John Maynard Keynes, *The General Theory of Employment, Interest and Money* (1936).

3 Cf. Moulton, *Income and Economic Progress,* 15 ff., 87 ff.; Fisher, *Booms and Depressions,* 3ff., 111 ff., 146, 158.

4 Bertil Ohlin, "Can the Gold Block learn from the Sterling Block's Experience?" *Index,* Bulletin of Svensak Handelsbanken, March, 1936. Richard A.Lester, "Sweden's Experience with 'Managed Money,'" Supplement to *Index,* January, 1937; Brinley Thomas, *Monetary Policy and Crises: A Study of Swedish Experience,* 1936.

5 *Income and Economic Progress,* 133, 134.

6 *Ibid.,* 2, 3, 112–114, 124–125.

7 Cf. Raymond T.Bye, "Capital Formation and Inequality," *Am. Econ. Rev.,* December, 1936.

8 "Commercial Banking and Capital Formation," *Jour. Pol. Econ.,* May, June, July, November, 1918.

9 *The Formation of Capital,* 75–160.

10 *The Formation of Capital,* 160, 151.

11 *The Formation of Capital,* 115.

12 Cf. Moulton on "How the commercial banking system manufactures credit," by which is meant credit currency, or deposit currency. *Formation of Capital,* 77.

13 Keynes, 81.

14 *Income and Economic Progress,* 144, 149.

15 See Moulton's *Income and Economic Progress,* 144, 149, and Commons, *Institutional Economics,* 563, 564. In the *American Economic Review,* June, 1935, I arrived at similar conclusions on Lewis Corey's *Decline of American Capitalism,* where substan-tially Moulton's ratios of net profit to capitalization were used as the basis of the communistic argument. Moulton's calculations are pertinent enough for his purpose of indicating roughly that "it is a fundamental principle of business operation that *added volume* [gross sales] of business ordinarily *pays heavily*." My purpose is to indicate how it is that statistical computations reduce "profit" to a passive concept because they cannot include the unknown future which the profit-seeker, that is, anybody who "trades on the equity," is "up against."

16 See Commons, *Institutional Economics,* 582 ff.

17 Cf. Lester and Thomas, *op. cit.*

18 *Formation of Capital,* 115, 46, 193; *Income and Economic Progress,* 182.

19 *Income and Economic Progress,* 125.

20 *Income and Economic Progress,* 87 ff.

21 Keynes, *op. cit.,* 271.

22 *Op. cit.,* 113 ff.

23 Preceded by David Hume as to metallic money.

24 *Income and Economic Progress,* 138 n.

25 *Income and Economic Progress,* 163, 162.

26 *Ibid.,* 154.

27 *Ibid.,* 163.

39
TWENTIETH CENTURY ECONOMICS

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Economics is a department of Social Philosophy. Nineteenth century economics began with the philosophies of the eighteenth century which culminated in the French Revolution of twenty-five years, followed by fifteen years of reaction and recovery. The Physiocrats in France (Quesnay 1758) and the Classical economists in England (Adam Smith 1776) were the forerunners of a world war based on the Rights of Man and Individual Action controlled by Divine Reason and Natural Law.

We are at the beginnings of a twentieth century economics culminating in another world war, already in its twenty-fifth year and moving on to further decades of reaction and recovery. Its forerunners were the socialistic and communistic philosophies of the first half of the nineteenth century (Mazzini 1840, Marx 1848), and their practical applications were the corporations, cooperatives, labor unions, political parties, of the second half of the century, based on the Duties of Man and Individual Action controlled by Collective Action.

In the eighteenth century a new world was opening up for conquest and the movement of populations from Europe. These were the economic opportunities for the individualistic philosophies and the individual action of the century.

At the beginning of the twentieth century Africa and Asia are parcelled among the European nations by conquest and control of markets; Australia and the Americas are occupied by Europeans; the conquests of Spain, France, Britain, are independent nations; Germany, Italy, Japan, demand "a place in the sun." These are the economic limits against which the collectivistic philosophies of the century were formulated and its collective action organized.

The original of eighteenth century philosophies was John Locke, contemporary and colleague of Sir Isaac Newton. Locke justified the English Revolution of 1689 on a theistic philosophy of divine beneficence, earthly abundance, and a labor theory of value that justified the acquisition of property rights in the divine abundance. Its practical application was the constitutional government of England and eventually of America, with an independent judiciary to protect property and liberty. The original of the classical economists, Adam Smith, followed Locke's divine beneficence, earthly abundance and labor theory of value, but separated economics and private property from the politicians who had taken control of Locke's constitutional government.

The individualism of the eighteenth century philosophies was not sheer selfishness; it was liberty, equality *and* fraternity—world citizenship for all. Converted into economics, it was free trade between equal individuals the world over. It was opposed to the selfishness of nations embodied in the policies of Mercantilism which had set up monopolies, tariffs, navigation laws and the exploitation of colonies and weaker peoples for the aggrandizement of one's own nation and privileged citizens. No more inspiring ideal of equal liberty has been written than that which was written by Adam Smith in the same year, 1776, contemporary with Jefferson's Declaration of Independence, as his foundation for the *Wealth of Nations*. World-wide division of labor, voluntary agreements between equal individuals the world over, were the economic details of this cosmopolitan philosophy. He converted liberty, equality, and fraternity, into economics. His, however, was but a world-wide extension of the common law of England, with its philosophy of a willing buyer and willing seller, expounded without success to King James by Chief Justice Coke at the beginning of the seventeenth century, but victorious in the English Revolution at the end of that century. Coke's common-law rights of Englishmen became Smith's natural rights of man.

The American Constitution, at the beginning of the eighteenth century revolutions, went further and set up a new form of government with an independent judiciary, previously advocated by John Locke, which again converted the common-law rights of Englishmen into the natural rights of man. America, also, preceded Europe by fifty years, in beginning to grant universal suffrage to the newly emerged wage-earners as the instrument for safeguarding their individual rights and voluntary agreements. The same social philosophy ended in the American social revolution of 1861 which liberated the slaves and gave to them citizenship. They, too, were to become willing buyers and willing sellers. The American labor movement, led by Gompers (1886), an immigrant from London, extended the same philosophy of voluntary agreements to the wage-earners of the cities.[1] Trade unions were his instrument of collective action devised to maintain equal liberty of individual action.

All philosophies, whether "natural" philosophies or "social" philosophies, are the seed-bed for germination of theories; the theories are broken down into hypotheses for particular problems; the hypotheses are tested by experiments to see which of them best fits the facts. If all who investigate and are competent can verify the experiments, their agreement is a "science." Others accept without investigation. If the circumstances change, or new facts emerge, a new combination of philosophies, theories and hypotheses is proposed, with further experiments and agreements by investigators, such that the science itself grows to fit the changes and discoveries in the facts.

On the natural science side were the discoveries and inventions in physics, chemistry, electricity. These inventions required eventually the huge modern physical plants and power-generators of railways, steamships, factories. The populations of Europe were transported by steam and met the populations of Asia. But the world's frontiers are closing, not so much by the pressure of population on the food supply, which is more abundant in spots than ever before, but by pressure to obtain control of the raw materials out of which modern science constructs its physical plant and power-generators. These required, on the institutional side, the organization of individual ownerships into corporate ownerships, with issues of stocks and bonds to represent shares of the collective participation. These required a credit system with its commercial and

investment banking corporations, in order to finance the expanding markets and physical plants. The wage-earners, not sharing in the ownerships, now began to appear in larger and larger aggregations assembled under the management of investors, and finally they organized themselves in their own unions, as the investors were organized in corporations. Meanwhile, to these unpropertied wage-earners was granted citizenship and universal suffrage, unknown before in the world's history. Political parties, considered by George Washington to be mere factions led by ambitious individuals, now became political organizations, even "machines," similar, in their field, to the corporations and unions in the economic field.[2] These political organizations became the economic instruments of sovereignty, apportioning the legal rights, duties, liberties and exposures to individuals and associations in the economic field.

There are the economic foundations of twentieth century social philosophies which generate the theories and hypotheses of twentieth century economics and the social sciences. It is not that the individualistic philosophies and economics were untrue—they were inadequate. They fitted the emergence of individual liberty from ancient oppressions, but not the emergence of collective liberty on the part of those who were liberated yet exposed to the collective liberty of others. While not untrue to the facts they were misleading. They loaned themselves to the illusions of logical certainty. Things worked out mathematically to an inevitable conclusion, and Newton had discovered the method. The conclusion was harmonious and beneficent, as befitted the deistic assumptions. If there occurred a collapse of the system, the collapse was temporary. But the prolonged depressions of 1893 and 1929 have substituted universal skepticism. While the same facts were always there, the combinations and magnitudes were new. It is this skepticism that finally has begun to split off "social philosophy" from the "natural philosophy" of Newton, Locke and the eighteenth century. Much as the "natural philosophy" of Newton became modern "science" towards the middle of the nineteenth century when stripped of deism, so "social philosophy" becomes the "social sciences" at the beginning of the twentieth century. The difference between the two is obviously the fact that the natural sciences deal with a subject matter which itself is purposeless, but the subject matter of the social sciences is a purposeful human being. Yet even this purpose does not dominate economics and the social sciences until it becomes the joint purpose of collective action showing itself in the rules and regulations which the organizations impose on individual action. So that the economic and social scientists cannot be disinterested, as were the natural scientists. They approve or disapprove, tacitly or openly, the corporations, unions or political parties which they investigate.

To change the figure of speech, social philosophy is the large atmosphere of mental speculation, not only among professional philosophers but also among all people, respecting the future of society, which the social sciences then reduce to theories and hypotheses for detailed investigation of the way in which practical men make use of the philosophies. It is not mere coincidence that twentieth century philosophies begin to call themselves "pragmatic"—not the individualistic pragmatism of William James but the social pragmatism of John Dewey,[3] elaborated upon the scientific pragmatism of Charles S.Peirce (1878). Nor is it accidental that the natural scientists begin to subordinate their physical sciences to the social sciences, at first defensively, in their conventions, as protests against the seemingly popular demand that they "take a holiday"; then perhaps constructively by taking into account the social consequences of their discoveries, and

devising plans to put their inventions into operation without bringing on unemployment. In this respect they fall in line with the so-called "social engineering" which, at the hands of Roscoe Pound, has begun to modify the science of jurisprudence, and has been finding a place in economics and the other social sciences.

In the social sciences their pragmatic application is in the new field of Administration, whether corporate management or political management, distinguished from the constitutions and legislative statutes which followed the eighteenth century abstract rights of man. In the first number of the *Journal of Social Philosophy* I write upon these more abstract relations between "Economics and Social Philosophy." Now I attempt to connect that article with the administrative departments of government. Administration is pragmatic social philosophy. It brings together again, this time by methods of scientific investigation, the separated fields of economics, ethics and jurisprudence which John Locke had united on the basis of divine beneficence and natural law.

Modern natural science, at the time of the French Revolution, had not yet begun to convert its discoveries into inventions for the control of nature's resources and other peoples. Ships were sailing ships, and the steam engine, invented in 1776, did not become the world's power-generator for transportation and manufactures until a half century after the close of that revolution. Nature and society were deemed to be governed by natural law, and the social sciences were subordinate to the natural sciences. Indeed, the human being was a mechanical unit, analogous to the chemical atom. In the present world war of the collectivist revolutions the nations listen to Berlin by wireless, conquest swoops from the air, gold and oil are lifted from miles below the earth's surface. Nature and society are governed by collective control of natural law, and the natural sciences are subordinate to the social sciences. Instead of investigating an individualistic human atom, they investigate the working rules and administrative decisions of all collective action.

Neither governments nor the social sciences were fitted to deal with the industrial and political revolutions of the last half of the nineteenth century. A new but fantastic "sociology" had been elaborated by Auguste Comte at the middle of the century which, however, for the first time proposed the modern method of historical and experimental investigation for all of the social sciences, similar to the methods of the natural sciences. Not until the twentieth century can it be said that his method was generally adopted, and not until the great war did economic investigators, on behalf of national administrations, comprehensively begin to assemble the facts and statistics needed for an administrative economics.

It was also at the middle of the nineteenth century that modern "nationalism" began to assert itself against the "cosmopolitanism" of the eighteenth and nineteenth centuries. Its first outbreak was the revolutions of 1848 in Europe and their sympathetic repercussions in America. Here were the beginnings of the several collectivistic philosophies. The impulse toward these revolutions came from the fate of those who had not yet been admitted to the suffrage and representation in governments. Only nations could create for them, and could protect for them, the natural rights which the cosmopolitan philosophies had set up as ideals for the world. The revolutions failed, but the governments that succeeded set about to obtain the national unity and supremacy which the revolutionists sought. Italy and Germany became nations instead of principalities. The American northern states fought for the Union supreme over state sovereignties. The Russian Empire absorbed nations and tribes previously independent. All of them took over, in

whole or in part, from England the plan of representative government in parliaments, and from America the extension of universal suffrage not fitted to representative government. All of them adopted protective tariffs against England and free trade within their national boundaries.

The unworkability of these nationalized systems culminated in the new world war and turned on the three main conditions of modern capitalism—universal suffrage, pressure of population and the credit system of conducting business and government. I briefly mention them in turn as the conditions which have brought to the front Administration as the fourth branch of American government.

The first modern government founded on universal suffrage was Tammany Hall in New York City. The suffrage had been extended by New York State to non-property owners in the decade of the 1820s. Tammany Hall had been a political club of professional men and small property owners. In the decade of the 1830s it became also a society of leaders of the several political clubs of newly enfranchised non-property-owners, paralleling by wards and ward politicians the elected Board of Aldermen. Other cities followed. At the beginning of the twentieth century more than one-half of the American population is congregated in the larger cities, each with its local political leaders and organizations. Manhood suffrage had been extended by the Western states as a real estate speculation to attract immigrants, as Tammany had enrolled the immigrants. Each locality, East and West, developed its political leaders and organizations paralleling the legislative and congressional territorial districts, as Tammany had paralleled the municipal wards. National political parties emerged, not based on differences of opinion or on divergent principles of political philosophy, but simply as national syndicates of these local and state political managers in control of taxes, corporation privileges, jobs, public property and poor relief. Thus did practical men convert into administrative economics the eighteenth century philosophies of liberty, equality and fraternity when extended to universal suffrage.

It was these local political parties that Mussolini suppressed by shooting the leaders without trial, *habeas corpus,* or newspaper publicity. He enthused a younger generation of idealists who had despaired of popular government. Their attempted suppression in America has begun by due process of law, at first through local prosecuting attorneys, latterly through the new Federal Bureau of Investigation of the Department of Justice, and the Federal Courts.

Other nations developed their peculiar methods of adapting themselves to the cosmopolitan philosophies of liberty, equality and democratic suffrage. The Central and South American military dictatorships, the Russian dictatorship, the Japanese dictatorship, became one-party political systems sailing under the flag of parliamentary government. Germany, Italy and France developed a dozen political parties in their legislatures, representing different political philosophies, afterwards reduced in Italy and Germany to a one-party system. England and America reduced theirs to a two-party system. The political parties became the organized means of maneuvering the populations into a unity of national government and a distribution of economic privileges. Representative assemblies were subordinated to the party organizations, and universal suffrage was discontinued, sometimes in part as in the case of American ex-slaves, elsewhere discontinued altogether as a means of selecting the representatives in government.

History, in a sense, repeats itself. The absolutist monarchies were the dictatorship stage of Feudalism at the hands of a victorious feudal chief (Henry VII, Louis XIII) who opened the way for early capitalism. We live to see the beginnings of the dictatorship stage of ripened Capitalism (Mussolini, Hitler). In the one case the absolute monarchy reduced the freedom of private warfare among the feudal barons into a national sovereignty; in the other case the dictatorship reduces the freedom of competition for markets into a national control of markets. The centralized physical power (sovereignty) converted private warfare into private property, and converted the aristocratic debts of honor into legal contracts. The centralized economic power (scarcity) converts universal suffrage into national administration of nature's limited resources by corporations and political parties.

Next, the pressure of population is always relative to the earth's developed resources of the time and place. The pressure begins at spots. It began in the mountains and deserts of Arabia and Asia, in the frigid regions of Europe, in the modern great cities larger than ancient nations, in modern nations shut out from markets and the world's supply of food and materials. Hitler promises *"Brot und Arbeit"* to a Teutonic race which through twenty centuries has spread from the Baltic to the Roman Empire, to the British Isles, to America and the world. Mussolini promises a new Roman Empire to the pent-up Italy of the Caesars. An Asiatic nation, with modern science, spreads from its narrow island to the continent of Asia. Tammany Hall, in the decade of the 1830s, began to furnish bread and jobs to the unemployed of New York. American political parties copied Tammany for the nation. The economic foundation of foreign conquest and internal politics is the increase of population faster than the developed resources of the locality or nation, and faster than markets. It has become, in the twentieth century, almost the sole foundation. The question is not, Who is to blame? If one leader disappears, another takes his place. All of them get their recruits, in Europe and America, by promises of bread and work. The leaders of American corporations and their political spokesmen make the same promises if they are relieved from governmental regulations and taxes.

If the pressure of population begins in spots, it is timed by the credit cycles. The long business slump after 1825, continuing with slight recoveries until 1850, was the germinating period of modern political parties, of the collectivistic philosophies of 1848, of the American conquest of Mexico through to the Pacific in 1845. The seven-year slump after 1893 was followed by America's conquest of Spain and the European conquest of Africa, followed later by its redistribution in the world war. The deepest slump of all, after 1929, drives Italy into Africa and renews a world war against closing frontiers.

This credit system is the most delicate system of government ever invented. Its foundations are honesty and thrift. It converts the savings of individuals into farms, railroads, factories, the manufacturing and marketing of commodities. Its legal foundations are the enforcement of contracts and corporate franchises granted by governments. Its economic strategy turns on the extremely narrow margins for profit on sales of products, scarcely 5 percent of sales on the average in prosperous times, total loss of profit in business slumps, after paying all the debts contracted for wages due to laborers, for interest and principal due to investors, for rentals and royalties due to land owners and patentees. This narrow margin for profit is the dynamic factor of the capitalist system. All other participants are passive, waiting to be hired, bought, or borrowed. It is a

future margin of credits and debits, the narrow margin on which all the expected risks of the world are focused before they hit the other participants. The world's planning for the future is done through the credit system on relatively narrow margins of expected profit.

The system is new. England preceded, other nations followed. Since the middle of the nineteenth century it has become a system of corporation credit directed by central banks of issue and discount; and in the twentieth century it is almost solely the planning for future markets by corporate management in industry and banking. Governments furnish the corporate charters and enforce the contracts, but management does the planning.

These three main features of modern capitalism, universal suffrage, population pressure and the credit system, are inseparably involved together.

Scientific inventions have increased the efficiency of the population as much as fourfold *per capita* during the past century and have relieved the pressure of closed frontiers. But the credit system precipitates cycles of overemployment and unemployment, and creates false ideas of profit and wages for immediate profit and daily wages instead of long-time stability and steady incomes for the future. While the credit system is usually deemed to finance markets and physical plant, what it really finances is employment. But, with its collapse, a strange new system of barter between nations takes the place of individual freedom of international credit. Universal suffrage creates pressure groups which deadlock deliberative assemblies, as notoriously happened in Italy. The new pressure groups of enfranchised wage-earners, two-thirds of the population seriously unemployed, turns out to be the provocation of communism, fascism, nazism, and their American repercussions. In former depressions, with unemployment, it was not necessary to pay attention to the wage-earners. They did not have the suffrage and were unorganized. Now it is necessary to feed them or suppress their organizations.

It is questioned whether the American system can cope with these new political and economic problems. The open frontier made the effort feasible for the nineteenth century, where it was not feasible for Italy and Germany with frontiers already closed. But the world's closing frontier throws America into the world conflict. The new problems are the menacing problems of social science investigation and the administration of collective action.

"Administration," as suggested above, is the meeting place of social philosophy and the collective action that distinguishes present-day economics from the nineteenth century abstract philosophies. On the one side it is the "pragmatic philosophy" of present-day social sciences;[4] on the other side it is the problem of collective action in control of individual action. Collective action, with its working rules, takes the place of the divine law and natural law that descended from John Locke and the eighteenth century philosophies.

On the side of private organization, administration is corporation management, trade-union leadership, the management of farmers' unions, the maneuvering of pressure groups, the management of a family. On the governmental side it is the management of political parties and, in the American constitutional scheme, it is a fourth department of government emerging out of the three legislative, executive and judicial departments prescribed by the written constitutions.

Considering the way in which this fourth branch of government has developed under American constitutional limitations, and the gaps which it was created to fill, it is an investigational branch of government ancillary to the other branches. But its

investigations are not the mere search for truth, they are designed to improve conditions within the field assigned to the particular commission. This first appearance was in the health departments of cities and states, creating a place for technical experts of the medical sciences in the administration and improvement of laws protecting the public health. Such experts, experience showed, could not be elected and continued in office by popular vote.

Extended from public health to the broader economic fields, the gap filled by this investigational branch is the field of the various “class conflicts” which characterize modern economic action. In the field of “public utility” commissions it is the conflict between railway corporations and shippers, manufacturers, merchants, farmers, local chambers of commerce, the pioneer being the Interstate Commerce Commission, or between the corporations supplying water, gas, electricity and the purchasers of those services. In the field of Karl Marx’s unique “class struggle” it is the industrial commissions, the new “social security boards,” which make rules and regulations governing employer-employee relations as to safety, health, wages, employment, unemployment, hours of labor, the mediation and arbitration of collective bargaining, covering almost the entire field of the social sciences. There are the market commissions, fair trade commissions, issuing rules governing the qualities, standards, weights, measures, purity, of commodities and the practices of competitors formerly left to the classical free competition. There are the tax commissions endeavoring to apply the rules of equality between corporations and individuals. There is the Federal Reserve Board regulating the relations between creditors and debtors, and the super-board of all, the Securities and Exchange Commission, entrusted with the central activity of the capitalist system, the rules and regulations of the Stock Exchange.

All of these boards or commissions, during the past forty years, have been in the experimental and debatable stage of the American endeavor to combine the legislative, executive and judicial activities of government, originally separated by the written constitutions. Historically, in their earlier formulations, and especially within the past five years, they have usually been held by the state and federal courts to be unconstitutional, on the various grounds of unwarranted delegation of legislative power, unwarranted interference with states’ rights, or in conflict with the all-inclusive individualistic philosophy which forbids depriving individuals of property or liberty without due process of law. Various changes in their organization and powers have been introduced to meet these nullifications by the courts, until, since 1937, the Supreme Court begins to nullify its own previous findings and seems to be approaching the position that, instead of vetoing the legislative act altogether, the Court will content itself with investigating the administrative rules and regulations as to whether these conflict with “due process of law” in that they are arbitrary, dogmatic, or partisan.

To examine completely the development of this fourth branch of government would require a treatise on American administrative law, but it is possible, relying upon my experience in drafting administrative laws and participating in their administration, to pick out the main philosophical and scientific features which have begun to make them a recognized part of the American economic system. They are resolved substantially into a social science investigational branch of government, along the lines of so-called “social engineering.” The Supreme Courts of the United States and the several states, in their reviews of rules issued by these commissions, pay first attention to whether the

Commission has taken into account and given "due weight" to all of the facts pertinent to the order that has been issued as a rule of action. This inquiry conforms to the historic "rule of reason" of the common law which becomes an inquiry as to whether substantial justice to all parties has been provided for in regulating the future transactions between individuals or associations of individuals. This rule of reason becomes, in its varied applications, a social philosophy of "reasonable value," "reasonable" practices, usages, or customs, by which is meant reasonable consideration of all the conflicting interests of all the parties affected by the administrative rule. If the rule is thereby found to be "reasonable," then it is "constitutional." In this respect of the relations of the parts to the whole, the rule must conform to a "public purpose" which, on analysis, taking all of the commissions into account, is found to be the whole field of social philosophy and the social sciences.

These administrative commissions, with their provisional rule-making authority, fit experimentally into the American system at the points where the abstract nature-philosophies of the preceding two centuries of the rights of man failed to meet the problems created by their own logical extension to new fields. They have been extended to universal suffrage with its resulting pressure groups inside closing frontiers, under a delicately balanced credit system of government.

They are administrative but not executive, for the commissions have no authority to execute their own orders. They are legislative but not representative, for they do not make abstract universal rules applicable to all persons in similar situations at all times, but they make only particular rules applicable to investigated situations and changeable on short notice, by a body always in session, whenever the situations change. Hence they are usually boards or commissions instead of single-headed departments. They are judicial but not a judiciary, in that they are in the position of a prosecuting witness, and their rules on which they base their prosecutions are reviewable and amendable by the constituted courts before they can be enforced by the executives.

They are to be distinguished from the executive departments of war, navy, police, post office and other administration of public property, where business efficiency and military efficiency are wanted, in that they adjust the relations between conflicting social classes within the national economy.

They are distinguishable from the legislative departments in that the legislature sets the upper and lower limits of their discretionary power. Hence they are not revolutionary or drastic, except within such limits as their investigations may show that new measures are required to meet new and changing economic and social conditions. To the legislatures instead of the courts the people must look for the more far-reaching decisions on public policy. And these administrative bodies become the legislature's investigational agencies.

They are distinguishable from the judicial departments in that they do not decide disputes *after* the event, but they make preventive rules, somewhat like the equitable jurisdiction of the courts, against repetition of evils newly discovered, not however in the individual conflicts for which the courts were created, but in the varieties of class conflicts for which the courts are not fitted.

Here is the distinctive field where their investigations are concerned, not only with what has happened in the past but with what ought to happen and what is feasible in the future. In these respects their peculiar field of activity is the more or less technical and

scientific investigation of the new economic and social relationships, as an aid to, and even a moral restraint upon, the other departments of government. This meeting place of the social philosophies and daily life of the people is the experimental and constructive field of the social sciences, much as the laboratory experiments are the meeting place for new views of the natural sciences and newly discovered facts of the physical world. These investigational and inventive bodies, in their initial stages, are the focus of alarmed attacks from all sides, as seen in the five decades of the Interstate Commerce Commission, much as Galileo's revelations and Darwin's hypotheses were repugnant to the traditional assumptions during their initiatory periods of the natural sciences. It is all the more reason why social philosophy and the social sciences should focus their investigations upon, and train their investigators within, this fourth department of the American experiment in government.

NOTES

1 See Samuel Gompers, *Seventy Years of Life and Labor* (1925).
2 See J.R.Commons, *Proportional Representation* (1896, 1907).
3 See his *Logic of Inquiry* (1938).
4 Cf. Robert S.Lynd, *Knowledge for What?* (1939), and my review in *Amer. Econ. Rev.,* September 1939.

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LEGISLATIVE AND ADMINISTRATIVE REASONING IN ECONOMICS

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The promotion of Justice Stone to the position of Chief Justice of the United States, as well as the veto by the President of the Walter-Logan bill requiring judicial interference in administrative investigations, make significant the contrast in opinions of Justice Stone and Justice Roberts in the case, decided January 6, 1936, on the constitutionality of the Agricultural Adjustment Act of 1933.[1]

Two equally competent institutional economists reach opposite conclusions on the same statement of facts in their theories of sovereignty and scarcity. The explanation is, not in the facts, nor in the mental capacities or integrity of the justices, but in their two methods of reasoning. Justice Roberts, for the majority of the Court, in declaring the Act unconstitutional, followed a legislative method of reasoning from extreme cases; Justice Stone, for the minority at that time, followed an administrative method of reasoning from an actual case statistically located somewhere between the extremes.

The distinction, historically in treatises on logic, is perhaps known as the difference between deductive and experimental reasoning, a distinction, however, not exactly valid for even the physical sciences where it originated.[2] And now, considering the way in which the distinction has come forward in the science of economics, it is the difference between a legislative method of reasoning without the economic distinctions of kind, quantity, degree, time or place, and an administrative method where the quantities, degrees of economic power and the timeliness of action are the determining points in reaching a practical decision to act.

The economic issue, as it came to the front in this case, was the use of *economic power* by the government in enforcing its commands, additional to its historical use of physical power.[3] The Congress, in adopting the Agricultural Adjustment Act, had assumed, in conformity with traditional economists and Courts that economics was a field of *voluntary* agreements, contrasted with sovereignty as the field of *compulsory* agreements. But now, with the increased intensity of private use of economic power over individuals in the collective forms of corporations, labor unions, cartels, federal reserve

banking, and with economic power further intensified by the closing of the world's frontiers against escape, these arguments of Stone and Roberts become a new constitutional debate whether the American government shall use economic power on behalf of unorganized farmers and others to counterbalance the organized economic power of other classes. Justice Roberts denied, and Justice Stone affirmed, this governmental use of economic power.

In this debate the meaning of "economic power" took on the two constitutional forms of "property" and "liberty." Property, whether private ownership or public ownership, is the power of *scarcity*—the power of the owner to command obedience of others by withholding from them what they need but do not own. Liberty, the liberty of an owner, his "economic liberty," took the form of "spending power," equivalent to the economists' "freedom of exchange," or "purchasing power," "buying power," "bargaining power," the liberty to fix or agree on prices or values by control of supply or demand.

In general, it had been assumed by economists and courts that this economic power was limited by free competition between equal individual owners, and this was the reason why economic agreements were deemed to be voluntary rather than coercive. It followed that the only place of government in the economic scheme was in the negative power *(laissez faire)* of preventing conspiracy or monopoly, either of which interfered with free competition and was therefore coercive rather than voluntary.

Justice Roberts denied that either a state government or the federal government was permitted, under the Constitution, to use this economic power. He argued that its use by government was coercive against private parties and not voluntary agreement on their part, and was therefore prohibited. His leading case was a decision ten years earlier by the same Supreme Court against the use of economic power by a state railroad commission.[4] In that case a State administrative body had attempted to use the public ownership of the highways as its means to compel a private corporation to submit to regulation of rates by the State commission. Justice Roberts showed that the State government and the State commission had then used the same argument of a "voluntary" agreement on the part of the private corporation as the federal government and the Agricultural Department were now using on the part of the farmers. The Court had then said, as quoted by Roberts:

> Having regard to form alone, the act here is an offer to the private carrier of a privilege, which the State may grant or deny, upon a condition which the carrier is free to accept or reject. In reality, the carrier is given no choice, except a choice between the rock and the whirlpool—an option to forego a privilege which may be vital to his livelihood or submit to a requirement which may constitute an intolerable burden.

Thus the economic power, in this case of a State administrative department, consisted in public ownership of the highways. Its use as a fulcrum of bargaining power by the State commission was coercive upon a private corporation by withholding the use of the highways if the corporation would not submit to regulation. The same argument was now advanced by Roberts against the use of the "spending power" by the Department of Agriculture to compel obedience on the part of farmers. He said:[5]

> …the Secretary is not required but is permitted, if, in his uncontrolled judgment, the policy of the Act will be so promoted, to make agreements with individual farmers for a reduction of acreage or production, upon such terms as he may think fair and reasonable…. The Government asserts that whatever might be said against the validity of the plan, if compulsory, it is constitutionally sound because the end is accomplished by voluntary cooperation. There are two sufficient answers to the contention. The regulation is not, in fact, voluntary. The farmer, of course, may refuse to comply, but the price of such refusal is the loss of benefits. The amount offered is intended to be sufficient to exert pressure on him to agree to the proposed regulation. The power to confer or withhold unlimited benefits is the power to coerce or destroy. If the cotton grower elects not to accept the benefits, he will receive less for his crops. Those who receive payments will be able to undersell him. The result may well be financial ruin. The coercive purpose and intent of the statute is not obscured by the fact that it has not been perfectly successful. It is pointed out that, because there still remained a minority whom the rental and benefit payments were insufficient to induce to surrender their independence of action, the Congress has gone further and, in the Bankhead Cotton Act, used the taxing power in a more directly minatory fashion to compel submission. This progression only serves more fully to expose the coercive purpose of the so-called tax imposed by the present act. It is clear that the Department of Agriculture has properly described the plan as one to keep a non-cooperating minority in line. This is coercion by economic pressure. The asserted power of choice is illusory.

This citation to the Department of Agriculture had reference to a leaflet entitled *Agricultural Adjustment* quoted by Justice Roberts as follows:

> Experience of cooperative associations and other groups has shown that without such Government support, the efforts of the farmers to band together to control the amount of their product sent to market are nearly always brought to nothing. Almost always, under such circumstances, there has been a non-cooperating minority, which, refusing to go along with the rest, has stayed on the outside and tried to benefit from the sacrifices the majority has made…. It is to keep this non-cooperating minority in line, or at least prevent it from doing harm to the majority, that the power of the Government has been marshalled behind the adjustment programs.

Thus the Supreme Court, in these two cases, attacked the two components of economic power. In the state highway case it was the power of ownership to withhold supply from all parties. In the Agricultural case it was the power to withhold supply of government funds from a minority of competitors, and thus restrain their liberty, in order to increase the bargaining power of the class as a whole against all other classes. Justice Stone's arguments were concerned with the latter. He said:

> That the governmental power of the purse is a great one is not now for the first time announced. Every student of the history of government and economics is aware of its magnitude and of its existence in every civilized government. Both were well understood by the framers of the Constitution when they sanctioned the grant of the spending power to the federal government, and both were recognized by Hamilton and Story, whose views of the spending power on a parity with the other powers specifically granted, have hitherto been generally accepted. The suggestion that it must now be curtailed by judicial fiat, because it may be abused by unwise use hardly rises to the dignity of argument. So may judicial power be abused. "The power to tax is the power to destroy," but we do not, for that reason, doubt its existence, or hold that its efficacy is to be restricted by its incidental or collateral effects upon the States…. The power to tax and spend is not without constitutional restraints. One restriction is that the purpose must be truly national. Another is that it may not be used to coerce action left to state control. Another is the conscience and patriotism of Congress and the Executive.[6]

Herein Justice Stone agreed that the use of economic power by the government was coercive, similar to the power of taxation, and that both were subject to abuse in extreme cases. The implication, however, that economic power had been equally coercive at the time when the Constitution was framed or for a century afterwards is doubtful. During that period there was an open frontier for escape, with only a few or weak corporations or unions, and no organized administrative banking system. Applicable, however, to its increased coerciveness in recent times, Justice Stone proceeded to show that economic power was not unlimited in its practical administration. His arguments in this field of institutional economics may fittingly be named the foundations for a fourth branch of the American government, the branch of Administrative Economics.[7]

Justice Stone and Justice Roberts agreed that the Adjustment Act was "coercive" instead of "voluntary." They differed on the issue of its administration. The grounds for their respective positions will appear from its provisions. The Act started with a preamble of general welfare, defined as the "orderly exchange of commodities" in the "national credit structure," broken down, however, by the "present acute economic emergency," which destroys the value of "agricultural assets." This destruction of value was attributed mainly to the "severe and increasing disparity between the prices of agricultural and other commodities." The stated purpose of the Act was to "establish and maintain such balance between the production and consumption of agricultural commodities and such marketing conditions therefor" as will restore the purchasing power of certain designated agricultural commodities to the level of a base period, August, 1909, to July, 1914. This level was define as "parity," or "fair exchange value" with manufacturers' prices, to be ascertained by the Secretary of Agriculture from "available statistics" of the Department. The termination of the emergency for each commodity was also provided for; and was declared to be such date, to be likewise determined by statistics, when "parity" should be re-established for that commodity. The Secretary should have the power to provide for "reduction in acreage," or "reduction in the production for market," or for both, by "agreement" with producers or by other "voluntary methods," including benefit payments

to be paid to farmers who agree to the restriction of output, such as "the Secretary deems fair or reasonable." The Secretary should also have the power to determine an appropriate "processing tax," to be "levied, assessed and collected" upon the first manufacturing of the commodity, for the purpose of paying the ascertained reasonable benefits to the producers.

These were the general features of the legislative Act, to be administered for individual cases by the Department of Agriculture. There is no doubt about its novelty in American economics and jurisprudence, although it was modeled, as nearly as practicable, upon the protective tariff, and upon the well known restrictions of output by manufacturers in laying off employees and shutting down factories in order to maintain prices during emergencies. But in this agricultural case there was something entirely new, the restriction of food supply, symbolized by the extreme case of the slaughter of 6 million pigs by administrative process, known to the Justices, in order to maintain the price of hogs. This shocking fact, although somewhat parallel to the laying off of employees who needed work for the subsistence of themselves and families, was parallel to the case actually before the court which had to do with cotton, the clothing of the people. The slaughter of pigs, or the restriction of cotton acreage, or the limitation of other food production by administrative process, in order to create scarcity and thereby raise prices during a credit emergency—was it constitutional or unconstitutional?

An emotional result of reasoning from extremes is the fear of what an actual case, if once permitted, might lead to. It might lead to communism, fascism, or anarchism. Short of these last extremities it might lead to other dangerous extremes. Justice Roberts agrees that this power to spend on behalf of farmers is subject to limitations, but fears what it might lead to. He says:

> We are referred to appropriations in aid of education, and it is said that no one has doubted the power of Congress to stipulate the sort of education for which money shall be expended. But an appropriation to an educational institution which by its terms is to become available only if the beneficiary enters into a contract to teach doctrines subversive of the Constitution is clearly bad.

Justice Roberts proceeds with other extremes of what the processing tax and its expenditure might lead to. It might lead to extracting money from one branch of industry and paying it to another branch, throughout the United States. It might lead to transferring money from farmers and miners to manufacturers. It might be used as an "indirect" power to reverse the recent decision of the Court that Congress had no "direct" power to regulate wages and hours of labor in local business.[8] It might lead to an excise tax of two cents per pound on every sale of sugar, to be turned over to the refineries. It might be used to reduce the output of shoes and clothing; and so on, in favor of any business group which thought itself underprivileged. "The supposed cases," said Justice Roberts, "are no more improbable than would the present Act have been deemed a few years ago."

In order to alleviate these fears of extreme cases of economic coercion which representative government might lead to, Justice Stone, in reply, referred to other cases not deemed to be absurd or extreme which the Roberts decision would lead to. The government might give seeds to farmers, he said, "but may not condition the gift upon

them being planted"; might give money to the unemployed, but not ask them to give labor in return; might give money to sufferers from earthquake or fire, but not impose conditions to prevent the spread of disease; "all that, because it is purchased regulation infringing state powers, must be left to the states who are unable or unwilling to supply the necessary relief." Many other cases are cited, and, in general, Justice Stone asked regarding the federal government, "Do all its activities collapse because, in order to effect the permissible purpose, in myriad ways the money is paid out upon terms and conditions which influence action of the recipients within the states which Congress might command?…If the expenditure is for a national purpose, that purpose will not be thwarted because payment is on condition which will advance that purpose."

The foregoing, again, indicates the difference between the generally understood physical power of sovereignty and economic power. Roberts denies but Stone affirms the exercise of the latter to both State and federal governments. Economic power has to do with its effects on prices and markets. These are foreign markets and such domestic markets as are beyond the power of the states, acting separately, to control. Both the protective tariff and the immigration restriction laws were designed mainly as economic measures, to enable manufacturers and laborers to maintain domestic prices and wages throughout the states against foreign competition. Justice Roberts's opinion, supported by the majority of the Court, denied the authority of the government to levy a processing tax, analogous to the tariff tax, in aid of those farmers who agreed to restrict output in order to maintain these domestic prices against either foreign or domestic competition. The Congress, in re-enacting the Agricultural Adjustment Law, omitted the processing tax, but provided for similar payments to farmers out of the general fund of the Treasury, regardless of the taxable sources. Apparently the promotion of Justice Stone, along with similar changes in the Supreme Court, renders the processing tax hereafter constitutional.

Justice Stone, as above quoted, mentioned three limits placed upon the federal government. The third limit, namely, the "conscience and patriotism of the Congress and the Executive," was further enlarged to include "wisdom." Wisdom, in Stone's usage, may be defined as good judgment in deciding upon what is reasonable coercion by government somewhere between the extremes of absurd coercion dreaded by Justice Roberts. Justice Stone said:

> A tortured construction of the Constitution is not to be justified by recourse to extreme samples of reckless congressional spending which might occur if Courts could not prevent expenditures which, even if they could be thought to effect any national purpose, would be possible only by action of a legislature lost to all sense of public responsibility. Such suppositions are addressed to the mind accustomed to believe that it is the business of courts to sit in judgment on the wisdom of legislative action. Courts are not the only agency of government that must be assumed to have the capacity to govern. Congress and the courts both unhappily may falter or be mistaken in the performance of their constitutional duty….

The other two limits on the taxing and spending powers mentioned by Justice Stone are the two jurisdictional sides of the same physical or economic power, namely, national sovereignty versus state sovereignty. The purpose must be truly national, which is the

same as saying that it must not interfere with matters left by the constitution to state control. It was in support of state sovereignty that Justice Roberts, for the majority, finally declared the Act unconstitutional, although his arguments were directed against the use of economic power by those state governments as well as the federal government.

Besides the issue of economic power as an instrument of sovereignty was the legal issue of the American attempt to separate the government into legislative, executive and judicial branches. Justice Roberts would maintain this separation by making out that the Court did not use the physical force of sovereignty. He said:

> It is sometimes said that the court assumes a power to overrule or control the actions of the people's representatives. This is a misconception. When an Act of Congress is appropriately challenged in the courts as not conforming to the constitutional mandate, the judicial branch of the government has only one duty—to lay the article of the Constitution which is invoked beside the statute which is challenged, and decide whether the latter squares with the former. All the court does, or can do, is to announce its considered judgment upon the question. This court neither approves nor condemns any legislative policy.

Against this disclaimer of judicial power, as a mere logical or intellectual power of opinion without physical force, Justice Stone set up the argument of a truly sovereign power of the judiciary in that it has the last word in the American system of divided sovereignty. He said:

> The power of the courts to declare a statute unconstitutional is subject to two guiding principles of decision which ought never to be absent from judicial consciousness. One is that courts are concerned only with the power to enact statutes, not with their wisdom. The other is that while unconstitutional exercise of power by the executive and legislative branches of the government is subject to judicial restraint, the only check upon our own exercise of power is our own sense of self restraint. For the removal of unwise laws from the statute books, appeal lies not to the courts but to the ballot and to the processes of democratic government.

Thus the Court, having the last word in affirming or preventing the use of physical force, and having its own executive officers, is really sovereign. Like other sovereigns, it is limited only by its own sense of self-restraint.

We may observe in addition, from the economic standpoint, that this internal sense of self-restraint may find external guidance in the statistical investigations presented by the Department of Agriculture for the Court's consideration. By reasoning from extremes, these statistical showings of what was to be done between the extremes are ignored. Yet it is their statistical validity, as furnished and critically examined by its own investigational staff, and then subjected to public hearings of all parties, that constitutes, one might say, the whole of administrative economics.

These public hearings include a specialized modern development which would be included under what Justice Stone characterized as "the processes of democratic

government." It is not only the indiscriminate and accidental public that is heard, but also the more interested public of those directly and economically to be restrained by the regulations to be issued by the Department. This was the actual procedure of the Department of Agriculture in its investigations, revising and correcting its own previous rulings and mistakes, and consulting the advisory committees of farmers on its statistics and its proposed economic restraints, as well as submitting the plans to referendum vote of the particular farmers who produced the crop in question. This "democratic process" was prescribed, in part, in the Act, and was known to be the process followed by the Department. This again enforces the inference that Justice Stone would not, without further Congressional mandate, approve the judicial restraints on the Agricultural Department contained in the Walter-Logan bill, but would refer the investigations back to the Department and its process of consulting the farmers.

These considerations emphasize still further the economic character of this alleged fourth branch of American government. Under the American system of attempted separation of powers, neither the legislature, nor the administrative agency operating under powers delegated to it by the legislature, has the strictly *executive* power, contemplated in the Constitution, of enforcing by physical force its own commands, or "orders." The only constitutional possessors of this physical power are the President (or state governor) and the judiciary. The former is commander-in-chief of the army and navy and of such other subordinates as use physical force; the judiciary commands the marshals (or sheriffs) who obey without investigation. Justice Roberts's "power of judgment" is, in fact, a command issued by the Court to the United States marshal (or sheriff) ordering the use of physical force, if necessary, to stop the administrative process. I have myself seen it operate upon an administrative colleague of mine, who thought he knew better than the Supreme Court of the State. Justice Roberts's alibi is dismissed.

This command is effective because the administrative department, as just now suggested, is not itself an executive department in command of the physical force needed to carry its own decisions into effect. It may not arrest or imprison anybody. It may not resist the marshal or sheriff. It must make application to the Court to issue its own order to use force, and must submit its arguments. Its power is only investigational and advisory in so far as the legislature authorizes and the Court approves. As a so-called "fourth branch" of government it is more nearly like a standing committee for economic investigations and recommendations to the three recognized branches, and to the people generally. If in addition, it has discretion in issuing orders to individuals the reason why the latter do not challenge the orders by appeal to the Court for review and reversal is because they expect that the courts will decide as they had formerly decided. In this respect the administrative "orders" are analogous to the force of custom. This is, indeed, the only ground of assurance that the Agricultural Department will have economic power in each case as it arises, namely, the expectation that the Supreme Court and the inferior courts will follow the reasoning of Justice Stone rather than Justice Roberts, and refuse to interfere with its administrative investigations and decisions.

This assurance is indeed also the ground on which corporations and labor unions are able to exercise their collective economic power. They are forbidden to use physical violence, but they have the double assurance, in the American economic system, that the courts will not use their own command of physical force to interfere with the private organizations in their use of economic power, and that the courts will further use this

same power to enforce their contracts or "voluntary" agreements. Thus the reason why they also are designated as "voluntary" by their spokesmen, is not because their economic power is not economically coercive, but because it is not physically coercive—quite the same meaning of "voluntary" as that which the Congress employed in its delegation of economic power to the Agricultural Department.

These traditional views about the non-coerciveness of economic transactions, which now are recognized as coercive by both Justice Stone and Justice Roberts, indicate that the Court has contradicted the arguments of so eminent a jurist as Professor Corwin, who had predicted the "twilight" of the Supreme Court on the assumption that the Court could not, or would not, undertake to control the "spending power" of the government. As soon as this "spending power," which is "economic power," is recognized as coercive through collective action, on account of such evident denial of freedom as suggested by the choice between the "rock and the whirlpool," then the issue falls between extreme cases of abuse and a reasonable use somewhere between the extremes. This reasoning also applies to private collective use of economic power in the hands of corporations, banks, labor unions, and the like, for which the older individualistic meanings of "voluntary" economic agreements continue to be used, but are obsolete. The Agricultural Adjustment Act was certainly, as Roberts contended, the use of coercive economic power by the government, not recognized by Corwin as coercive, on behalf of a great economic class who had not themselves learned how to use it collectively in dealings with corporations, banks and labor unions.[9]

It follows from the foregoing that the reliance on statistics is characteristic not only of the modern science of economics, it is also, more emphatically, the reliance of modern administrative economics in carrying out the legislative policy. But it is not a hit-or-miss blind statistic—it is guided by economic theory, which is economic analysis of the several factors. This guidance has both its legal and its economic side, united in the modern administrative department.

On the legal side the statistical method of reasoning from actual cases had always been, in fact, the historical method in Anglo-American jurisprudence in cases of "fair competition," between the extremes of "destructive competition," or "chiseling," and monopolistic competition. As such, it was the point, to be discovered by proper judicial investigation and "due process" of notice and hearing, where each of the conflicting interests at the time and place were given its "due weight" in reaching a judicial decision. The cases turned mainly on valuations of "intangible" property known as "goodwill," "trade name," "trade reputation," claimed by one or more of the parties to a transaction. In more recent times this method of reasoning from specific cases becomes an administrative method when delegated by the legislature to a governmental department, like the Interstate Commerce Commission or the Department of Agriculture, with its staff of economists and statisticians, instead of the courts without this type of investigators.

But this delegation of authority for economic investigations on which to base decisions was obstructed during about twenty years of hostile decisions by the courts before it was conceded by the Supreme Court in the field of such monopolistic public utilities as railways regulated by the Interstate Commerce Commission. And now, with the public regulation of similar monopolistic competition in other fields, and with changes in the personnel of the Supreme Court, it becomes the recognized method of administrative reasoning, permitted by the Courts, not only for the Agricultural

Department in the use of economic power, but for other administrative departments, whether headed by an individual like the Secretary, by a board or commission, or by a "public corporation," like the Tennessee Valley Authority.[10] All of them are in fact standing committees for economic investigations and recommendations to the government and the people, with the power of custom in enforcing what are really provisional orders effective as long as not lawfully contested elsewhere.

This is the modern development on the legal side of the American separation of powers. On the economic side the use of statistics is the starting point of facts and policy. On calculations derived from these statistics the Secretary of Agriculture was directed, in each year in advance of the plantings, to ascertain the amount of rentals or benefit payments to be paid to each farmer the coming year, in consideration of his reduction of crops by such amounts as would be deemed sufficient, with the other farmers during the emergency, to restore the price parities of twenty years before.

These statistical limits, of course, do not of themselves restrict the discretion of the Secretary of Agriculture. In the constitutional government of America the actual limits had been set by the judiciary in its control of administrative officials. In such control, as has happened with the Interstate Commerce Commission, the Court, in actual cases as they arise, eventually learns to respect the statistics and thereby to determine whether the final decision of the administrative authority comes within the "rule of reason." Such consideration is superfluous when reasoning from extreme cases. Justice Roberts, on that account, would exclude altogether the use of economic power, but Justice Stone would submit its use to the historical doctrine of the rule of reason.

Thus, on both the legal and the economic sides, the transition is made from the dogmatic economics of the nineteenth century to the statistical, investigational and administrative economics of the twentieth century.

But the use of statistics presupposes economic theory, which is economic analysis. The inconsistency of the proposed reduction of the nation's food supply in order to raise prices at the very time of unemployment was in the background of Justice Roberts's reasoning. The inconsistency was not adequately met in the "Brief of the United States." This Brief, using the "infant industry" argument, emphasized the greater possibilities of *reducing prices* in manufactures on account of machine technology, compared with the inability of farmers to use "mass production technics" in order to *reduce* the prices of farm products.

Here the Brief did not properly make the analysis of a credit emergency contrasted with the long-time trend of technology. This argument of the government before the Court, on technological grounds, would support the communist conclusion that small-scale production in agriculture must give way, in the long-run trend of increasing efficiency, to large-scale mass production, so that the independent farmers would be reduced to wage-earners employed by agricultural corporations.

But such an outcome was opposite to the purpose of the Congress. The statistics purported to show that the inconsistency existed only during the emergency. The emergency was stated definitely to be a matter of the "credit structure" which had broken down, instead of a matter of increased technological efficiency. It is the distinction between "producing power," which increases abundance by machinery, and "bargaining power" which withholds abundance by ownership, and is the inconsistency of capitalism itself, based on private property. The purpose of the Congress was to preserve, during the

emergency, the individual farmer in his bargaining power, as essential to the "national credit structure," instead of permitting him, in the credit emergency, to be reduced to the extreme of a propertyless wage earner. The government's legal argument, at this point, inconsistently supported, in fact, the inference of Justice Roberts that, by government aid, farm prices would be *reduced* by "underselling," whereas the statistics supported the argument of the economists of the Agricultural Department to the effect that, by administrative restrictions of output during the emergency, farm prices would be *raised* relative to industrial prices.

The distinction is basic for economic analysis, and has been brought out by statistical economists under the name of "business cycles," only during the past thirty years. A credit collapse creates an emergency which, in the economic theory of Congress, might be overcome by restoration of the preceding level of purchasing power deemed to be "parity." But a technological trend of increasing efficiency is a long-run trend of centuries, and was, indeed, the kind of gradual change contemplated by nineteenth century economists when speaking of the temporary displacement of labor by machinery, counteracted, "in the long run," by their optimistic increase of prosperity by increased efficiency over the centuries.

A more fitting emergency analysis of the credit collapse is in the comparison of *methods* of manufacturers in counteracting their falling prices by reducing output through shutting down plants and laying off employees during the emergency, and the *methods* of farmers who cannot shut down their farms, nor lay off themselves and families, even for a few days. They must go on producing a surplus at falling prices while the manufacturers are maintaining prices by unemployment.

But the emergency argument recognizes that credit operates in cycles. It therefore contemplates that the emergency will disappear by some form of recovery from the disparities of the business depression, either an economic recovery that will increase demand and raise prices, or even a military recovery by war. The latter we unhappily see is actually happening, and the restrictions are not only being removed by the Department, but the farmers are actually urged to enlarge output instead of reducing output.

This effort of the Department of Agriculture to enlarge output by farmers is claimed by its critics to be a reversal of its policy and an acknowledgment of its former economic fallacies when it was restricting output. But it is not a reversal nor a confession. It is a consistent policy of "adjustment" to the credit cycle—an adjustment by means of administrative process which protects the farmers during the credit depression when needed, and removes the protection during credit recovery when not needed.

This distinction between credit cycles which are temporary ups and downs, but are the normal workings of the credit system, and technological efficiency which has steadily increased during centuries by mechanical inventions, is the most important of all distinctions revealed recently by statistical analysis. It is a distinction not at all recognized by the traditional economists, by the politicians, by the courts or by the public generally, as shown by the above criticism directed against the Department of Agriculture. The distinction enforces the need of recognizing Administrative Economics, as against legislative or judicial economics, and especially in the field of agriculture. An administrative department alone can meet promptly the "adjustments" needed to ward off inflations and deflations of prices, or bring relief promptly in time of deflation.

The Adjustment Act of 1935 is almost the first Act of American legislation designed specifically to counteract this credit cycle. In the case of tariff legislation, by contrast, there is required a political campaign, spaced at four years, to adjust the tariff to prosperity or depression. This is confirmed by economic history. The high tariff party, for more than a hundred years, has nearly always won its votes during a depression in business, as an instrument for protection and recovery for the benefit of *producers*. The low tariff party, then, usually gets its votes after prices and wages have risen with prosperity, as an instrument for reducing the high prices of protected industries, for the benefit of *consumers*. But the Agricultural Adjustment Act by means of daily investigations and statistics, increases its protection of agriculture during the depression when needed, and reduces or removes its protection when agriculture recovers prosperity, without waiting for political campaigns, legislation, or court action.

Something similar occurs in the judicial economics of antimonopoly, or anti-trust prosecutions. A judicial trial requires prolonged preparations and delays, reaching its decisions usually after the emergency has passed; and then there is no effective provision for a rehearing or readjustment to fit the emergencies of prosperity or depression. But the administrative economics of "agricultural adjustment" was designed to fit itself to the "disparities" of monopolistic inequalities suffered during the depression by farmers in their dealings with manufacturers or unions, and then to fit itself to the "parties" of restored equality of bargaining power during the ensuing period of prosperity.

This is the emphatic difference between administrative economics and legislative or judicial economics in the American system of attempted separation of powers. The defenders of judicial economics, in their opposition to administrative economics, set up the contrast of a "government by law," meaning a government by courts, against a "government by men," meaning administrative departments. But, with the statistical developments of economics and administration, the contrast is more properly government by delay and exclusion of economics against government by timely economic action based on preparatory statistical investigations.

While the method of extreme cases creates absurdities and is the fruitful field of satire, it leads to no conclusions, of course, regarding the actual rentals and benefits to be paid by the government during the time of emergency, nor the actual restrictions on output or sales made by the farmers. They were not, however, the extremes of "unlimited benefits." The administrative method of reasoning from actual cases, as suggested by Justice Stone's argument, proposes that the Court should consider the statistics of limited benefits during a limited period of emergency, instead of condemning the legislative plan as a whole for all time. It is a change from unconstitutionality of a legislative act as a whole to reasonableness of an administrative act statistically determined in detail for a specified time and a specified industry or occupation.

Reviewing the arguments, there were three points at issue in the case, each with contrary opinions by Justice Stone and Justice Roberts. First, the destruction of pigs, or the restriction of crops, was a *legislative* question according to Justice Stone, but a judicial question according to Justice Roberts. Second, the *spending* power of the government is its economic power, an "indirect" power of withholding instead of a direct physical power of compulsion, and the use of this economic power is a legislative question, according to Stone, but a judicial question according to Roberts. The third issue, how far into the details of control over individuals the administrative authority

shall be permitted to go, if not prohibited altogether, was afterwards before the Congress in the Walter-Logan bill, applied to all administrative agencies. The bill was adopted by the Congress, on the theory of government by law instead of men, but was vetoed by the President. This bill, when reduced to its practical workings from the standpoint of economic investigations, meant the use of the injunction by the courts at any stage of the proceedings, in order to prevent administrative officers from summoning witnesses, taking testimony, or otherwise proceeding towards an administrative investigation or decision. The bill, in effect, authorized the lower courts to rehear and reject any of the testimony or investigations of administrative authority, and to hear any *new* testimony not heard by the administrative, instead of referring it back for consideration by that agency. If such a case should arise, in the absence of further legislation like the Walter-Logan bill, the Supreme Court, if it follows Justice Stone's opinion, would apparently not permit the lower judiciary to interfere *during* the administrative process; but afterwards, in review of the whole case, as provided by the Constitution, would treat the matter as a *legislative* issue to be decided by the Congress in its control of the administrative agency.

It is only by the use of statistics that the essential distinctions in economic investigations can be made for guidance of administrative action. The Courts, not equipped with a staff of qualified economic statisticians must depend upon an administrative department, or upon cross-examinations by lawyers of the prosecution and defense, for discovering or rejecting the facts. Then they pass only upon the procedure, as to whether it was a fair fight or not. They usually exclude the economic facts as irrelevant or indifferent. If, then they presume to reason without the statistics, they resort to the deductive reasoning in economics which does not discover whether the particular case, under the circumstances, is an extreme use, or a reasonable use, at the time, of economic power. So it is that Justice Roberts did not propose to make the many economic distinctions required in practical affairs, such as differences in kind, differences in quantity, differences in degree of economic power as indicated by different prices, wages, values, or differences in time of depression or prosperity. This is the reason for naming his method the legislative method of reasoning without statistics.

But Justice Stone's reliance on administrative reasoning requires many differences to be discovered by analysis and statistics, such as differences in bargaining power, producing power, intellectual power, the "power of judgment," the power of taxation, the regulations of commerce, the police power, etc.

It also requires distinctions in many *degrees* of the same kind of power, from the least possible to the highest possible degree, as well as the most vital of all distinctions, that of timeliness in an emergency, or in the slow routine of long-time trends, on which depend the decisions of immediate, or deferred action, or no action. Deductive reasoning, though it may be perfectly logical and valid as a mental operation at all times, on the assumption of unchanging circumstances, is separated from the realities of actual life where choices are made between different degrees of different kinds of power at each successive moment of living, both in emergencies and routine. In this process the Court does not abdicate—it always retains the last word in its final review, as provided by the Constitution and asserted by Justice Stone.

The legislature, also, is not equipped with qualified statistical investigators, except as it provides and finances them for the administrative departments. Hence the various debaters *pro* and *con* in the legislature proceed to argue their case from extremes, and

there could usually be no agreement reached were it not for the familiar despotic device of majority vote which suppresses the minority. By such a vote the legislature finally lays down its general policies and gives its instructions to the department to investigate and carry out the policy in detail for the particular cases as they come to the front in the changing circumstances. Here, in the administrative department, there is usually no majority and minority vote—only an economic statistical investigation which finds, for the particular case, the most probable action needed to bring about the results intended by the legislature.

These are the main considerations necessary to build up a practical science of administrative economics, in contrast to the logical deductive science of the nineteenth century based on the presumption of thousands of isolated individual self-interests. Hitherto it had not been practical to consider the development of such a science, which deals with individuals subordinated to collective economic action of corporations, unions and governments, because it was probable that the Courts, without economic investigation, would nevertheless interfere with the administrative investigations and decisions. But with the prospect of the Courts' permissive attitude, as formulated by Justice Stone, an administrative science of economics can be gradually built up as an aid to both the public administration by state and federal governments, and the correlated private administration by corporations and labor unions, as well as the advisory agricultural committees and the organized banking system. Yet science can never do away with wisdom and conscience in its use of statistics.

Such a science depends upon the method of reasoning. In the attempted experiment of agricultural adjustment may be seen a repetition of earlier conflicts between the two methods. The older economists and constitutional lawyers might well have looked with fear, as many of them did at the time, upon what the protection tariff might lead to, since the government thereby departed from the extreme *laissez-faire* and individualistic liberty and self-reliance of their free-trade assumptions. But justices, like other people, may change their minds upon further investigation, and new justices become familiar with what had been fearful when first proposed. In view of such developmental changes, the tariff, in an extreme degree of economic power over prices, accompanied later by extreme immigration restrictions, has eventually been fixed and accepted in the Constitution.[11] What had been deemed extreme, or "improbable a few years ago," as Justice Roberts expressed it, is now taken for granted as customary.

This is because the former majority of the Court, in the Agricultural Adjustment case, followed an obsolete method of reasoning for an imaginary isolated farmer, whereas the situation called for concerted action in defense against other organizations. The "call" took the form of a body of farmers sufficient to create a "pressure group" in Congress, supported by the economists and statisticians of an administrative department, and reasoning from the historical parallel of the protective tariff, as well as the immigration laws. They proposed that the government should also use both its taxing power and its bargaining power to place the farmers during an emergency on a parity with the manufacturers and laborers protected by the tariff restrictions on imports and the immigration restrictions on labor supply. The older arguments of *laissez-faire* and self-reliance, although obsolete regarding manufacturers and laborers, whom the government was abundantly aiding against competition, continued to be repeated by Justice Roberts regarding the farmers. To help the farmers during an emergency, either by the use of

taxing power or by restrictions of output and increase of bargaining power, might lead to abusive extremes. Justice Stone, in effect, asks Justice Roberts to restrain his fears by examining, economically, statistically, and even historically and comparatively, the actual experiment, along with similar experiments on behalf of others. It is a recurrence of the historical conflict between emotional reasoning from imagined extremes and statistical reasoning from the facts discovered somewhere between the extremes.

Reasoning from actual cases somewhere between the extremes is what is meant in legal science by "reasonable." There had always been, as mentioned above, this other doctrine in the decisions where competition was, in fact, not free and equal but was more or less "monopolistic" or "unfair," namely the doctrine of "reason" or "reasonable value" and "reasonable practices." The courts thereby created, by imagination, it is true, a situation of freedom and equality applicable to the particular case, to be enforced by their legal control, if need be, of the physical force of sovereignty. It was this historic doctrine of reasonable value, to be ascertained in each case as it arose, between the polar extremes of coercion by either of the opposed participants in a transaction, that Justice Stone set forth in reply to Justice Roberts. And it is this doctrine, when aided by statistics, that furnishes the foundation for the alleged fourth branch of American government, already including a dozen departments, commissions and boards, namely the branch of Administrative Economics for the investigation and regulation of similar collective economic action by private corporations and unions.

In this administrative reasoning from actual cases found somewhere between extremes we are, or should be, conformably to Stone's argument, always comparing relatively the gains and losses for conflicting economic interests under actual circumstances in view of their bearing upon the public welfare. In the case of the Agricultural Adjustment Act, if we set up the actual liberty gained by farmers, which is freedom from coercion of prices and wages received or paid by them during the emergency, over against the economic liberties lost by other members of society, and by themselves, during the emergency, we should have a fair measure of the balanced equilibrium of public welfare intended to be brought about by the statute. This is the economic meaning of Stone's "wisdom" and the legal "rule of reason" when reduced to the economists' statistical "weighted averages," depending also on good judgment of time, place, quantity, kind, and degree of power.

In modern economics the fears are mainly the fear of collective action, whether by governments, or by corporations or unions. All collective action is looked upon with fear as leading straight to dictatorship. But actually, in the cases as they arise, all kinds of collective action can be investigated to see whether, at the time and place, they are conducive to more real and equal freedom for individuals than the types of collective action which they displace. Collectivism and individualism are not incompatible except when reasoning from extremes at either end. There they may lead to revolutions, because the parties cannot agree, and will not submit to majority vote. But between these contradictory extremes of the north and south poles of reasoning are the actual transactions of individuals governed by the actual collective action of corporations, unions and governments, at the time and place. This is the field of institutional economics based on good judgment and full investigation of issues between conflicting interests. It is the problem of administrative economics in actual cases rather than unconstitutionally in all cases.

The problem does not simplify the science of economics: it makes the science more complex and difficult—even vital to existence. But it makes the science less dogmatic and satirical by making it more investigational and practical—perhaps conciliatory.

This is the broader implication of the Agricultural Adjustment case raised by the urgent issue of totalitarian dictatorships. The question is whether, in the matter of corporations, unions and other concerted action, the American government shall follow its historical negative policy of preventing conspiracy and monopoly by legal prosecutions in all cases, or follow, in large part, its positive policy of regulating them according to its historic doctrine of reasonable value and reasonable practices during a time of war emergency as well as credit emergency. This is no longer an academic question of theory; it is a question of survival of the American form of government and its system of economics. Justice Stone's opinion lays the legal foundations for this regulation of private collective action by administrative departments, instead of prosecutions by attorneys or suppression by dictators, while the modern statistical science lays the economic foundations. To suggest a paraphrase of the debate between Justice Roberts and Justice Stone, it is a method of "laying down" the American system of law and economics by the side of the totalitarian system, during the emergency, and passing "judgment" on whether, notwithstanding its monopolistic abuses in extreme cases, it "squares" with a "reasonable" approach, under the circumstances, to a "democratic process."

NOTES

1 U. S. *v.* Butler, 297 U. S. I, 56 S Ct. 312 (1936).

2 The following argument turns on the statistician's familiarity with the theory of probability and its frequency curves, thereby the statistician becomes skeptical of random samples and extreme cases, and gives to them but little weight.

3 The term "power" as here used relates to the operation of threats and promises in getting present obedience in anticipation or avoidance of future alternatives. See Bertrand Russell, *Power* (1938). Russell distinguishes Power from Energy, the latter being the force in physical sciences. But he omits economic power, by stressing military power and propaganda.

4 297 U. S., citing Frost Trucking Co., *v.* Railroad Commission of California. Decided June 7, 1926.

5 297 U. S., 55, 70, 71.

6 297 U. S., 86, 87.

7 See James M.Landis, *The Administrative Process* (1936). Dean Landis considers mainly the *procedure* in this branch of government compared with the procedure in the legislative and judicial branches, rather than its foundations for a science of Administrative Economics. For a comprehensive account of the Department of Agriculture, see Gaus and Wolcott, *Public Administration and the United States Department of Agriculture* (1940). Also, *Yearbook, 1940,* of the Department of Agriculture.

8 Schechter Poultry Corp. *v.* U. S., 295 U. S. 495.

9 E.S.Corwin, *The Twilight of the Supreme Court* (1934). More recent decisions tending further to overrule Justice Roberts' opinion by tending to enlarge the spending power of the Federal Government are Helvering *v.* Davis, 301 U. S. 319, 57 S. Ct. 904 (1937); Alabama Power Co.

v. Ickes Federal Emergency Administrator of Public Works *et al.,* 302 U. S. 464, 58 S. Ct. 300 (1938); Duke Power Co. *et al., v.* Greenwood County *et al.,* 302 U. S. 485, 58 S. Ct. 306 (1938); California Water Service Co. *et al., v.* City of Redding *et al.,* 22 F. Supp. 641 (1938) decree affirmed 304 U. S. 252, 58 S. Ct. 865 (1938). These citations furnished by Mr Philip M.Glick, U. S. Dept. of Agriculture, August 13, 1941.

10 See David E.Lilienthal, "The Conduct of Business Enterprises by the Federal Government," *Harvard Law Review,* February, 1941.

11 Especially the Immigration Restriction Act of 1923.