E. E. NEMMERS

HOBSON AND UNDERCONSUMPTION

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by

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1956
NORTH-HOLLAND PUBLISHING COMPANY
AMSTERDAM
KELLEY & MILLMANN, INC., NEW YORK

FOREWORD

The formal histories of economic doctrine slight the economic underworlds, except possibly the Socialist ones. As a result, the doctrinal history of underconsumption in particular has still to be written. If ever it is written, among its main sources will be detailed studies of individual heretics. Of these latter Hobson is certainly among the leaders, and so my colleague, Professor Nemmers, does us a service with a full-dress critical monograph on Hobson's wide range of ideas, written from an eclectic vantage point which combines training in the rival orthodoxies of the Austrian School, Marshall, Keynes, and the American Institutionalists. As a secondary service, Nemmers has also compared Hobson with five of his noteworthy predecessors (Sismondi, Lauderdale, Malthus, Rodbertus, and Marx) although Hobson studied none of them with profundity and cannot be listed among their intellectual descendants. Nemmers' discussion of these writers, however, concentrates on comparisons with what he finds in Hobson and is not intended as equivalent or substitutional for the same sort of treatment which he has given Hobson.

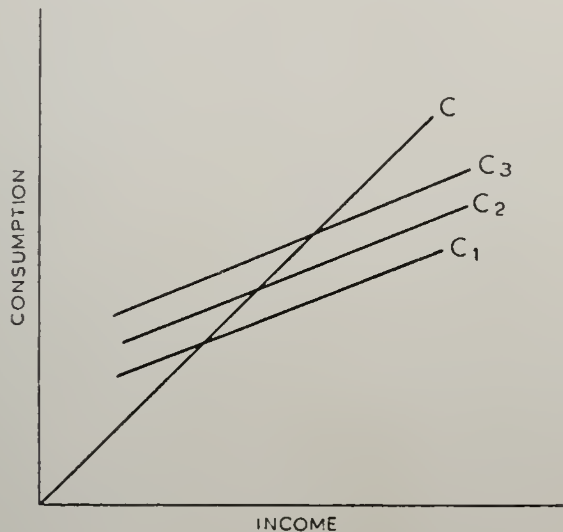
Hobson is not an easy man to summarize justly. If Alfred Marshall or Allyn Young wrote too little, Hobson wrote too much. He turned out 53 books in 49 years, not to mention scores of periodical articles. Most were pot-boilers, but the four* which have been (or are being) reprinted since Hobson's death in 1940 will alone suffice to ensure his place in the history of his subject. If not a system-builder, he was a storehouse of ideas. Catholics, Communists, Fabians, Keynesians, New Dealers, all have found inspiration in his pages. But not, unfortunately, in the same pages. This is what makes Hobson so difficult to summarize

* *The Physiology of Industry, The Evolution of Modern Capitalism, Imperialism, The Science of Wealth.*

justly. His pages come "thick and fast, and more and more and more," not always fully baked or thought through or tested for rigor or consistency, to the point that his ultimate "message" is nearly lost in confusions, lacunae and contradictions. But surely the notions of unequal bargaining power (imperfect competition?) as the cause of economic surplus, which is the cause of maldistribution of income, which is the cause of over-saving or under-consumption, which is the cause of industrial depression, which is the cause of imperialism—surely these notions in something like this order form most of the steps on most of Hobson's intellectual ladders during his best period (1890–1910). Surely too, his principal remedies stand forth clearly: taxing away economic surpluses (Henry George writ large), and raising the bargaining power of the poor through State and trade union action. Surely also, to be critical, a relatively few characteristic deficiencies run through the whole corpus of his self-made economics. His monetary theory was weak; his capital theory was weaker; he never seems to have made up his mind about Say's Law and its refutation; he suffered from a peculiar blind antagonism to marginalism in any form; he did not face up to the standard Marxian rebuttals of "petty-bourgeois equalitarian reformism", meaning the long-term "falling rate of profit," the class theory of the State, and their several consequences.

The details I leave in Nemmers' good hands with only this general measure of general agreement. He has read many more of Hobson's 53 books than I, and likewise digested a larger fraction of what he has read. He has not, however, had the advantage of having known or studied under Hobson himself, either in England or in this country. If he has sinned by commission or omission, making his treatment something less than definitive, Hobson's surviving disciples and associates are in a better position to find him out than I, who share Nemmers' ignorance of Hobson at first hand.

One emendation, space permitting, I should however like to make, although I am not sure that Nemmers will accept it. It has the effect of translating Hobson rather further into Keynesian and even post-Keynesian terms than Keynes or Nemmers has done. Suppose that we interpret Hobson's assertions that all savings are in fact invested as a precursor of Keynes' identity of savings and investment *ex post*. Suppose also that we interpret Hobson's assertion that there is one correct savings ratio as a precursor of the Kuznets, Duesenberry, and other "long-run consumption functions" passing through the origin of the familiar "Keynesian cross". Add to this apparatus a series of Keynesian "short-run" consumption functions, shifting upward over time, and the result is the diagram shown below. (The C_i are short-run consumption functions, and C is the long-run one.)



What Hobson is saying, in this view, is that no C_i can stay for long to the right of C without provoking a slump, nor can it stay for long to the left of C without provoking a recovery. Both the slump and the recovery are due primarily to the reactions of prospective profits and therefore investment to the paucity (or plenty) of consumption expenditures compared to the long-run normal. The recovery, moreover, will be slower than the slump by reason of the persistence of excess capacity from the preceding boom.

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ACKNOWLEDGMENTS

I desire to acknowledge the comments and suggestions at various stages of the several chapters by Professors James S. Earley, Martin Glaeser and Harold M. Groves. But in particular, I express my appreciation for the generous availability of Professor Martin Bronfenbrenner with time and counsel as well as patience.

In the case of a writer as prolific as John A. Hobson, special value attaches to more than usual documentation. This is particularly true where consistency is frequently a question and where Hobson's anti-academic bias eschews theoretical symmetry.

INTRODUCTION

Until recent years underconsumptionist theories of the business cycle have consistently received less attention from economists than over-investment, innovation, monetary and other explanations. Haberler[1] has pointed out several sound reasons for this condition:

1. "With some exceptions, their [underconsumptionist] scientific standard is lower than the standard" of other theories.

2. "The underconsumption theory is a theory of the crisis and depression rather than a theory of the cycle."

3. "In its best-reasoned form (e.g., in the writings of Messrs. J. A. Hobson and Foster and Catchings) the under-consumption theory uses 'under-consumption' to mean 'over-saving'."

In the past few decades, particularly since the appearance of Keynes, *General Theory of Employment, Interest and Money*,[2] we have witnessed a revival of interest in the precedents for Keynesian underconsumptionist thinking. The fundamental Keynesian tool, the consumption function, together with the basic Keynesian policy, compensatory finance, have given an underconsumptionist bent to the development of business cycle theory.

Underconsumption theory has followed two broad paths of development, not always separated. The first is the so-called "real" explanation giving primary emphasis to the role of income maldistribution or gluttability of consumption wants as the causal factor of underconsumption. The second is the so-called monetary explanation giving primary emphasis to the role of defects in the "price-system" interpreted as a monetary phenomenon, particularly the alleged existence of money costs not matched by money income.

In the stream of development of "real" underconsumption

[1] Gottfried Haberler, *Prosperity and Depression* (Lake Success: United Nations, 3d ed. 1946) pp. 119, 122.
[2] London: Harcourt, Brace, 1936.

theory, the role of John A. Hobson was comparatively neglected[3] until Keynes[4] paid the following tribute to him.

> "Theories of underconsumption [after Malthus] hibernated until the appearance in 1889 of *The Physiology of Industry*, by J. A. Hobson and A. F. Mummery, the first and most significant of many volumes in which for nearly fifty years Mr. Hobson has flung himself with unflagging, but almost unavailing, ardor and courage against the ranks of orthodoxy. Though it is so completely forgotten today, the publication of this book marks, in a sense, an epoch in economic thought."

As regards Keynes, this was not a case of belated recognition since in 1930 he wrote of Hobson[5]:

> "Mr. J. A. Hobson and others deserve recognition for trying to analyze the influence of saving and investment on the price-level and on the Credit Cycle, at a time when orthodox economists were content to neglect almost entirely this very real problem. But I do not think they have succeeded in linking up their conclusions with the theory of money or with the part played by the rate of interest."

In a broad sense and in essence, Keynes marks the culmination of the "monetary" underconsumptionist explanations and Hobson heads the "real" underconsumptionist explanation.[6]

[3] A continuous line of appreciation of Hobson has existed among American universities only at the University of Wisconsin and by John A. Ryan at Catholic University of America. Ryan has been quite specific in his position. In his autobiography, *Social Doctrine in Action* (New York: Harpers, 1941), pp. 64–68 he explains his complete acceptance of Hobson:

> "More than twenty-five years ago, I drafted a dedication which I thought of using (but ultimately did not use) for my book, *Distributive Justice*. It reads as follows:
> "To John A. Hobson, whose illuminating analysis of the economics of production and distribution, has greatly facilitated the author's attempt to determine the morality of these processes."
> The part of Mr. Hobson's economic doctrine which interested me most when I was a student at the University is also the part to which I have given most attention ever since, and for which my indebtedness to him is greatest. I allude to his theory that underconsumption and oversaving are the main cause of industrial slumps and depressions."

[4] John M. Keynes, *General Theory of Employment, Interest and Money, op. cit.*, pp. 364–65. Keynes devoted pp. 364–71 to Hobson.

[5] *A Treatise on Money* 2 vols (New York: Harcourt, Brace, 1930) Vol. 1, p. 179.

[6] As Keynes himself argues, *General Theory, op. cit.*, p. 367 "—The root of

Both approaches have had some explorers since then but the followers of Keynes are more numerous, with the primary development of at least the data for Hobsonian analysis coming from the recent studies of the National Bureau of Economic Research.

Although Hobson has received some incidental attention from leading economists[7] and some sketches of his work exist[8] no full length consideration of his economics is available[9] except for his welfare economics.

Hobson's main contributions to economics lie in four areas:

1. theory of underconsumption (see below Chapters III and VI).
2. theory of imperialism (Chapter IV).
3. theory of taxation (Chapter VII).
4. welfare economics, as defined by Hobson.

While Hobson's approach is generally colored by his views re-

Hobson's mistake—[is] his supposing that it is a case of excessive saving causing the *actual* accumulation of capital in excess of what is required, which is, in fact, a secondary evil which only occurs through mistakes in foresight, whereas the primary evil is a propensity to save in conditions of full employment more than the equivalent of the capital which is required, thus preventing full employment except when there is a mistake of foresight."

[7] E.g., Alfred Marshall, *Principles of Economics* (London: Macmillan 1920, 8th ed.) p. 409n: "Mr. J. A. Hobson is a vigorous and suggestive writer on the realistic and social sides of economics; but, as a critic of Ricardian doctrines, he is perhaps apt to underrate the difficulty of the problems which he discusses... The study of changes in complex quantitative relations is often vitiated by a neglect of this consideration" [referring to Hobson's rejection of the marginal concept].

Joan Robinson, *Essays in Theory of Employment* (New York: Macmillan, 2 ed., 1937), p. 173 and *Economic Papers* (New York: Macmillan, 1951), pp. 6f, 7, 8 n., 167, 170.

[8] The best of these is G. D. H. Cole's "John A. Hobson; 1858–1940," *Economic Journal*, vol. 50, pp. 315–60 (1940). See also Nicholas Mirkowich, "John A. Hobson's Economics," *Indian Journal of Economics*, vol. 23, pp. 175–185 (1942); W. H. Hamilton, "Economic Theory and Social Reform: Work and Wealth," *Journal of Political Economy*, vol. 23, pp. 562–84 (1915) and other items in the Bibliography.

[9] This, apparently, is the cause of an underestimate by Alvin Hansen, who writes: "After reading Lauderdale and Malthus, one gains relatively little from Hobson's work" (*Business Cycles and National Income*, New York: Norton, 1951, p. 255). Hansen is apparently relying on Haberler's statement that the essence of Hobson can be found in three of his volumes (*The Industrial System*, London: Longmans, 1909; *Economics of Unemployment*, New York: Macmillan, 1922; *Rationalisation and Unemployment*, London: Allen, 1930) and so confined his readings.

garding welfare economics,[10] it is a fact that the first three areas stand united, without the logical necessity of any of his welfare arguments. Hence the scope of the present study does not include any full consideration of Hobson's welfare economics which by orthodox definitions of economics lies more in the field of philosophy than economics.

[10] The ethical implications of Hobson attract such diverse followers as Communism (e.g., Lenin's indebtedness to Hobson's theory of imperialism to be discussed in Chapter IV below) and Catholicism (e.g., Ryan's acceptance referred to *supra*, n. 3).

CHAPTER I

EARLIER UNDERCONSUMPTIONISTS EMPHASIZING THE CAUSAL ROLE OF "REAL" FACTORS

JEAN SISMONDI (1773–1842)

Jean Sismondi[1] in his theory of markets states a theory of crises in which emphasis is laid on the deficiency in consumption resulting from the poverty of the masses. He does not consider the *relative* share of the worker as important in income distribution but rather his *absolute* amount as inadequate. He seems to imply that if a certain absolute level were reached by wages, then the productive capacity of industry would not outrun the market for its products. In the system of Sismondi, the logic would not be disturbed by substituting for maldistribution of income a malproduction of types of product, which he does in fact list as at least a subsidiary element following on maldistribution of income.[2]

Sismondi is not primarily an economist, but an historian.[3] As with most underconsumptionists, he displays a basic interest in welfare or social justice and is principally concerned with the study of distribution. The principle of competition and the separation of labor and ownership, together with the gluttability of wants, are the bases for underconsumption in his analysis. When the worker is independent, balance exists between population which the workers can plan, expected consumption, and

[1] *Nouveaux Principes d'Economie Politique* (Paris: Delauny, 1819) primarily vol. 1, ch. iv for our purpose, but also vol. 2 in part.
[2] *Ibid.*, II, pp. 312ff; pp. 417–26.
[3] His only other work in economics is *La Richesse Commerciale* (1803) which is orthodox Smithian economics. His chief works were elaborate histories of France and Italy.

planned production. Hence his recommendations of small owner-unit farms and shops, and the restriction of invention and other forces tending to destroy small production units. When capital and labor are separated, employment is determined by the demand of the capitalist for workers, and this fluctuates not according to the needs of consumers but according to the capitalist's opportunities for profitable use of labor and capital in production. As a result, the worker produces an over-population, developing overoptimism when he is unable to calculate his future.[4] This drives down wages and makes further production attractive to capital. Competition, in conjunction with the element of fixed capital, accounts for overproduction. Competition forces excessive production, first causing over-investment and then through longer hours and lower wages intensifying overproduction in an effort to recoup the over-invested capital.[5]

Sismondi lacks a unifying principle in his analysis. His proposals reject Communism[6] and see in government only the means of restraining invention and progress which intensify overproduction. Affirmatively, his answer is return to the small farmer, the artisan and the small shop. He recognizes foreign markets as a temporary solution.[7]

Much of the criticism directed at Sismondi is unfair. Thus Tugan-Baranoswky,[8] for example, maintains that Sismondi offers a theory of the crisis only and not of the cycle—a theory of permanent stagnation. Actually Sismondi was dealing with the extended post-Napoleonic war period of depression and it remains a question whether cyclical processes can be said to have existed at that time.

Like other underconsumptionists, Sismondi is most concerned with the analysis of the crisis, feeling that a true analysis automatically dictates the correct synthesis. He does, however, indicate the process by which overproduction is adjusted—i.e., by means of two broad paths.

[4] *Nouveaux Principes d'Economie Politique. op. cit.*, I, pp. 104–109.
[5] *Ibid.*, II, pp. 417–26.
[6] Although Marx and Engels acknowledge their debt to Sismondi in *The Communist Manifesto.*
[7] *Ibid.*, I, p. 361.
[8] *Studien zur Theorie und Geschichte der Handelskrisen in England* (Jena: Fischer, 1901), pt. 2, chs. 2,3.

First, unemployment and its concomitants contract the work force, driving wages ultimately up. However, there is no recognition how long this process takes. Second, capital is lost through unmarketability of excess production and its destruction, and recapitalized as to fixed assets through bankruptcy and forced sale.

While not primarily an economist and relatively unsophisticated in his theoretical apparatus, Sismondi has the bare elements of underconsumptionist thinking. He does not detail his propositions and is unable to make substantial policy recommendations other than the small unit of production owned by the worker.

Sismondi sets forth these elements which recur in the writings of most "real" underconsumptionists:

1. primary emphasis on welfare, on social as opposed to individual and material gains,
2. passing over of monetary phenomena, including interest theory,
3. stress on maldistribution of income as creating excess revenues in the hands of the rich and deficient revenues in the hands of the poor to move output at cost,
4. competition, or a price system, directing production for an unknown market leading to overproduction,
5. capital directing production on the basis of short-run profits and not for the needs of consumers,
6. a recapitalization theory of recovery,
7. a policy program for government on the premise that laissez-faire inevitably results in crisis.

LORD LAUDERDALE (1759–1839)

Although Lord Lauderdale is more sophisticated than Sismondi as an economist, he is not a true underconsumptionist in the same sense as Sismondi, Rodbertus or Hobson.[9] Three elements are missing from his thinking: there is no objection to capital directing production on a basis of short-run profits rather

[9] The best summary statement and the most generous appraisal of Lauderdale is in Alvin H. Hansen: *Business Cycles and National Income* (New York: Norton, 1951), pp. 229–240.

than needs of consumers, no criticism of competition as leading to over-production, and no emphasis on welfare considerations as such.

His primary emphasis on policy is indicated by the title of his principal work: *An Inquiry Into the Nature and Origin of Public Wealth*,[10] written in 1804. In this book he centers his theoretical structure around the British debt and its retirement in the eighteenth and early nineteenth centuries. His fundamental thesis is that a too rapid retirement of public debt will cause a contraction of national wealth (income) if sufficient investment opportunities do not exist to absorb the funds repaid, since recipients of debt retirement funds will not spend those funds on consumption.[11]

Lauderdale attempts to distinguish, in an elementary way, between what he called public wealth and private riches[12]. He sees clearly the principle that individual acts of saving taken as a group may be self-defeating by causing a shrinkage of aggregate demand[13] and, in consequence, a "forced parsimony." Intensive study of British debt during the eighteenth century led Lauderdale to his discovery. Rapid debt retirement caused the price of securities to rise and the interest rate to fall. Lauderdale did not consider the possibility that the demand schedule for investible funds might also be shifting downwards and to the left, although he seems to recognize that it is a matter of the relative volumes of investible funds and the demand for them. He recognizes that increased private investment might be more than offset by decrease in the public debt,[14] and hence the price of commodities might fall so that an apparent abundance would hide the failure of demand for consumers' goods[15] which must ultimately reflect itself in reduced demand for capital.

Several items Lauderdale sees clearly: decreased consumption associated with excessive debt retirement will usually cause a shrinkage of demand greater than the demand thus eliminated (a vague multiplier in reverse).[16] Secondly, the element of proportionality in the combination of factors of production is recognized.[17] Thirdly, the effect on the quantity of capital usable by

[10] Edinburgh: Constable, 1819.
[11] *Ibid.*, pp. 250–265. [12] *Ibid.*, pp. 57ff. [13] *Ibid.*, pp. 261f. [14] *Ibid.*, p. 255.
[15] *Ibid.*, pp. 260ff. [16] *Ibid.*, p. 246. [17] *Ibid.*, p. 204.

an economy at a given time as a result of the existing state of technology is recognized.[18] He can thus be said to be aware of the deepening of capital or autonomous investment determined by technology, and the widening of capital or induced investment determined by growth of consumption. Likewise he is acutely aware of income distribution and its relation to volume of consumption,[19] although he does not use an aggregate consumption function as such.

His policy recommendation is limited to the control of debt retirement to meet the current requirements of autonomous and induced investment. Little mention is made of changes in consumption due to changes in the propensity to save.

The role of the rate of interest and the significance of monetary phenomena pass largely unnoticed.

How Lauderdale would have approached other policy questions such as wage or price policy we do not know. It remains a question whether his apparently keen insight into the public debt question would have been sufficient to carry him through to a consistent underconsumptionist price policy, for example, particularly since his value theory, while breaking with Smith's analysis, was very rudimentary and without the schedule concept.

THOMAS R. MALTHUS (1766–1834)

Malthus sets forth his position on underconsumptionism in Chapter VII of his *Principles of Political Economy*,[20] published in 1820. He is primarily concerned with the development of the patterns of saving and consumption—the determination of aggregate demand and the factors which cause saving in excess of the capital requirements of an economy thus causing inadequacy of demand. He places less emphasis than Lauderdale on technology and demand for funds. Investment is considered primarily as induced and determined by the volume of consumption. Malthus breaks with Say and Ricardo primarily on the proposition that the act of saving does not insure demand for capital goods.

[18] *Ibid.*, pp. 224f. [19] *Ibid.*, pp. 318–20 and 344–64.

[20] In the second edition it is Ch. 1 of Bk. II. My references are to the 1936 London School reprint of the second ed.

Practically speaking, Malthus assumes that both saving and investment are interest-inelastic. He refers to "the structure and habits" of society and the "passion for accumulation" as determining saving and even the term "propensity to consume" is there. Not all saving is futile, but saving "beyond a certain point"[21]—with no analysis of what determines that point.

Malthus is not clear in his statement[22] but the post-Napoleonic period was one of a comparatively fixed technology and exhaustion of existing investment opportunities due to tremendous capital investment during the war. Under these conditions, a fall in the propensity to consume would result in a decline in induced investment. But he does not explicitly set out the conditions.

Malthus concurs with Lauderdale that debt retirement is involved in the failure of effective demand at that time, but carries his argument further. For Malthus reduction of taxes after the war gives rise to the increase in savings[23] by taxpayers who will not alter their spending patterns. For Lauderdale, excessive debt reduction gives rise to the increase in savings by the bondholding group; he states taxpayers can be assumed to spend tax reductions.

Malthus argues that countries victorious in war are at a disadvantage for capital outlets compared to the losers because of the greater destruction and disorganization suffered by the losers. The victors must seek to stimulate consumption—and maintaining wartime government expenditures is not justified even though it is known that tax cuts will result in excessive saving. Malthus recognizes that each increase in income and consumption will support additional saving.[24] He opposes trying to increase consumption through the inflationary process because the process of forced saving would give a spurt to capital formation. This is as far as Malthus recognizes monetary questions. The rate of interest, is considered entirely as a passive factor. To repeat, both saving and investment are treated as interest-inelastic.[25]

The policy recommendations of Malthus center in four propositions. The first three are:

(1) development of service industries,[26] (2) income equaliza-

[21] *Ibid.*, pp. 325f. Cf. J. J. O'Leary, "Malthus and Keynes", *Journal of Political Economy*, vol. 50, pp. 901-19 (1942) [22] *Ibid.*, p. 416f. [23] *Ibid.*, pp. 421–25. [24] *Ibid.* [25] *Ibid.*, p. 406. [26] *Ibid.*, p. 398.

tion, diffusing land ownership and public debt ownership,[27] and (3) international and domestic trade expansion, increasing the assortment of consumers' goods.[28] He recognizes the great difficulties in effecting these policies—the structure and habits of society are difficult to change. It is this matter which leads Malthus to advance his fourth proposition: encouraging "unproductive consumption"—a term which is sometimes unfairly twisted by his commentators.[29] By this term Malthus means consumption of the products of the service industries—and not parasitical[30] consumption. This he considered the most feasible policy. That this growth in service industries occurs *naturally* with increased productivity is not recognized by Malthus.[31]

Malthus, like Lauderdale, does not consider these elements as part of his underconsumptionism:

(1) primary emphasis on welfare, or social as opposed to material gain, (2) competition or a price system directing production for a market whose volume and price are unkown as leading to overproduction, and (3) capital directing production on the basis of short-run profits and not the needs of consumers.

Lauderdale and Malthus thus represent a different (partial) form of underconsumptionism by comparison with Sismondi, Rodbertus, Marx and Hobson.

JOHAN CARL RODBERTUS (1805–1875)

Rodbertus presents his underconsumptionist position chiefly in his *Letters to Kirchmann* in 1850–51 and his policy position in *Der Normal Arbeitstag*.[32] He follows much more in the tradition of Sismondi than of Lauderdale or Malthus.

[27] *Ibid.*, p. 426f. [28] *Ibid.*, p. 403.
[29] E.g., Eric Roll. *A History of Economic Thought* (New York: Prentice-Hall, rev. ed., 1946), p. 223 leaves the reader under misapprehension as to the meaning of this term.
[30] *Principles of Political Economy, op.cit.*, pp. 412–13; 463.
[31] For modern data on this subject, cf. Colin Clark, *The Economics of 1960* (London: Macmillan, 1942) and discussion and data below in ch. VIII, Table 11, p. 132.
[32] The edition of his writings used is: *Schriften von Dr. Carl Rodbertus-Jagetzau* (Berlin: Wirth, 1899). The *Letters* appear in English translation by Franklin as *Overproduction and Crises* (London: Sonnenschein, 1899). References are to this translation.

Production is dictated by demand and income rather than by the needs of consumers, and the economic machine is always working below the standard set by existing resources. Maldistribution of income plus the profit motive are the reasons for production smaller than is possible.

Rodbertus starts from a modified labor theory of value: only those goods are economic which have cost labor.[33] He contends there is exploitation in the incomes of landlords and capitalists. From exploitation stem poverty and crises. By poverty, he does not mean any absolute level, but a disparity between the actual level of income of a worker and a standard of living related to that income which the worker can use with his capacities.[34] This "poverty" arises from the failure of wages to keep pace with increases in labor productivity because (1) growth in population increases rents of land,[35] (2) population increases faster than labor productivity, and (3) under the competitive wage system, the capitalist has the stronger bargaining power.[36] This phenomenon goes on through good times and bad. It would go on even if population were stationary and productivity increased.[37] With the employment of fewer workers required for a given output, there is a fall in working-class purchasing power. If more goods are produced, a failure of the total of wages to increase with the total of goods leads to the same result.

While Rodbertus seems to deny[38] the Ricardian theory of rent, it is clear he means to deny it as a theory of what ought to be, or what is required by the economic facts, and not as a theory of the consequences of laissez-faire. Under laissez-faire, Rodbertus argues, rents rise faster than wages and profits, the landlord having a factor which is limited in quantity as opposed to the two other factors. Three further facts operate to increase the landlords' share:[39] (1) inequalities in land fertility (and in access to other raw materials), (2) the competitive system of uniform prices for product despite differing costs of production and the unpre-

[33] *Overproduction and Crises*, *op. cit.*, p. 90.

[34] *Ibid.*, p. 132. Thus literally there will always be poverty short of the millenium.

[35] *Ibid.*, pp. 26, 86. He misinterprets Malthus as holding that population increases in proportion to the food supply (*ibid.*, p. 31) and Ricardo as holding that wages rise in proportion to profits (*ibid.*)

[36] *Ibid.*, p. 44. [37] *Ibid.*, p. 123. [38] *Ibid.*, p. 69. [39] *Ibid.*, p. 33.

dictability of total demand,[40] and (3) the increase in population and unequal income distribution.

America's strength lies in low rents (free land) associated with relatively low population, while Ireland's misery is primarily due to high rents. Why, with this analysis, Rodbertus did not advocate some type of land reform as the solution to the crisis is not clear. He preferred a complete reform as indicated below and might have viewed land reform as an unsatisfactory compromise. Rodbertus makes as much use of statistical information as any economist of his period.

Crisis arises from the glut of goods. There is excess production of goods for the working class since their share of income is always shrinking, while the landlord and capitalist classes fail to consume their incomes. Their effort to invest such unconsumed incomes in means of further production must also fail. The ultimate output cannot be goods for the working class who lack the income to buy them. It cannot be goods for the capitalists who will not buy them because of their desire for continued saving.[41]

Only in the initial stages of this over-saving can there be prosperity and an increase in labor's absolute income even though the relative share decreases.[42] New capital applied to inventions rather than applied to existing technology must "undisputably prove most beneficial to society as a whole"[43] since this increases real income of all classes though labor's relative share decreases even in this process.

Rodbertus is close to Hobson in arguing[44] that there is one rate of saving relative to population which keeps consumption and production in equilibrium. A greater rate increases the glut. A lesser rate increases wage competition and therefore also glut.

He describes[45] the disasterous results of hoarding at the time of crisis, but he has no theory of the rate of interest.

Rodbertus objects[46] to nineteenth century classical economics as failing to place first "national property (the property of society), national production, national capital, national income, and

[40] *Ibid.* Rodbertus was an agriculturist and seems to have been thinking of the cob-web theorem.
[41] *Ibid.*, p. 48 "...too little is consumed by capitalists; that is, by those who have the means of consumption..." He denies that one of the outlets of saving is hoarding (*ibid.*, p. 52).
[42] *Ibid.*, p. 54. [43] *Ibid.*, p. 55. [44] *Ibid.*, p. 58. [45] *Ibid.*, p. 65. [46] *Ibid.*, p. 75.

its division into rent, profit and wages—and through these social concepts explaining the shares of the individual in them." He recognizes taxation and public finance[47] as proper tools of income distribution and not primarily for revenue purposes. Here he anticipates Hobson.

Likewise, Rodbertus recognizes[48] foreign markets as a temporary solution for an individual country possessing any relative advantage over other countries, and finds this is particularly the reason why England enjoyed relative prosperity despite being so advanced industrially. Here again he anticipates Hobson.

His major policy recommendations are found in an elaborate plan for government intervention in distribution.[49] From the establishment of a normal day's work in each industry (allowing for capital replacement), exchange ratios could be set by government for the various commodities, with allowance for state services and some remuneration for landlords and capitalists to be included in the calculation. Adjustment for changing labor productivity would be made periodically. This would eliminate poverty through worker participation in increased labor productivity. It would eliminate crises through guaranteeing that the total product *could* always be purchased by those who produced it. Monetary disturbances would be largely eliminated in connection with this program by basing money on wage units! Rodbertus rejects communism; but laissez-faire must be guided by government intervention.

KARL MARX (1818–1883)

With Karl Marx, the problem is the same as with Hobson: a voluminous statement of underconsumption in many works. In the cases of Sismondi, Lauderdale and Malthus it is possible to base a statement of their positions on relatively short presentations in a single work, although there are letters and other writings which need consideration. Not so with Marx and Hobson. The principal sources in the case of Marx are *Theorien über den*

[47] *Ibid.*, p. 87. [48] *Ibid.*, pp. 40, 58, 122.
[49] Suggested, *ibid.*, p. 80 and worked out in full in *Der Normal Arbeitstag, op. cit.*

Mehrwert[50] and *Das Kapital.*[51] His underconsumptionism is an integral part of his theories of labor value and surplus value. Marx, like Hobson, was more than an economist.

Marx begins with an "embodied labor" theory of value which makes labor not only the measure of value but also its sole creator. To this he adds the proposition that under capitalism, labor is dependent on capital to initiate production. Under these circumstances, the failure of labor to receive the entire product gives rise to exploitation, the retention by the owners of capital of the excess (or surplus) value which is defined as everything above the cost of subsistence of the laborer himself. Marx does not argue a short-run subsistence theory of wages, recognizing that wages may rise temporarily above that level through bargaining power, particularly during the period when new capital is being formed. But in the long run, this analysis produces the "Iron Law of Wages," when combined with competition from a "reserve army of the unemployed".

Capital is divided into constant and variable. It is the variable capital, the outlay for wages, which is the source of surplus value since only labor creates value. Capital accumulation takes the form of constant capital which, therefore, increases relative to variable capital. Unless the rate of exploitation goes up, capitalists experience difficulty in capturing additional surplus value at the same relative rate. Hence Marx's famous law of the falling rate of profit.[52]

The crisis arises from the capitalist's efforts to realize the surplus value and translate it into capital goods since the extraction of surplus value reduces effective demand for consumer's goods. In Marx, monetary problems are merely part of a larger whole and can intensify crisis difficulties although they are not essential to the crisis. Further, Marx claims more than an explanation of the crisis through this process, namely, the exempli-

[50] Ed. Karl Kautsky, 1904–10 in 3 vols. English trans. by Bonner and Burns, *Theories of Surplus Value* (London: Lawrence, 1951). (Selections).

[51] In 3 vols.: vol. 1, 1867; vol. 2, 1885 ed. Engels; vol. 3, 1894 ed. Engels, English trans. by Untermann, *Capital* (Chicago: Kerr. 1906–09).

[52] Expressed as an equation, $p' = \frac{v}{c + v} s'$, where p' is rate of profit, s' is rate of surplus value, v is variable capital and c constant capital. Other palliatives recognized by Marx are: 1) cheapening of constant capital, 2) overpopulation, 3) foreign trade, vol. 3, pp. 272–282 of *Capital.*

fication of a class struggle between workers and capitalists, and the spiral to communism through a series of crises. The underconsumptionist aspect involved in the translation of surplus value into capital goods is only part of the process of the crisis.

Marx rejects as naive the underconsumption theory of Sismondi and criticizes Rodbertus as arguing that workers cannot buy goods because the capitalists keep part of income. Marx recognizes that capitalists spend even the part they keep, but spend it on capital goods. In Marx, the inability to realize the surplus value causes things to go wrong through the increase in capital goods (causing competition between capitalists leading to more capital goods) and through the degradation of the working classes and the shrinking of effective demand (associated with the importing of cheap labor from non-capitalist cultures).

The mechanism tying the analysis together is the rate of profit. The rate of profit is defined as the ratio of surplus value to the total of constant and variable capital. Total output is equal to the total of constant capital replenishment, variable capital and surplus value. Constant capital increases through time relative to variable capital. Thus unless the rate of exploitation (S/V) increases, the rate of profit (S/[C+V]) falls. Marx considers the rate of profit constant in the short run and hence exploitation grows as constant capital grows. But in the long run the rate of profit falls with the increasing tendency towards large scale production as constant capital grows. At the same time the replacement of variable by constant capital gives rise to an industrial reserve army of unemployed. Quite aside from effective demand questions, class conflict will increase.

A part of the surplus value may be consumed by the capitalist. In the later stages of accumulation, the capitalist will, contrary to the usual underconsumptionist doctrine, have a higher propensity to consume. A second part of surplus value, but progressively a smaller relative part (though always a larger absolute part), is added to variable capital for wage outlay. A third part of surplus value is translated into constant capital. Marx recognizes a rising wage rate during this process to enable the labor class to multiply.[53] The balance, or lack of it, between these three parts, to-

[53] In this he separates himself from Rodbertus who clings to a relatively declining wage level throughout the build-up to the crisis.

gether with the rate of exploitation and the productivity of labor, which can be construed as technology, determine the occurrence of crises.[54]

Accompanying this process is the concentration of capital in fewer hands through competition between capitalists and, with the relative decline of variable capital, the Marxian "industrial reserve army" of idle workers grows and the *rate* of profit falls for the capitalist but the *absolute* amount of profit continues to grow.

In Marx, the conditions for *realizing* surplus value are distinct from those determining its *creation*. The underconsumptionist theory of Sismondi, Malthus, Lauderdale and Rodbertus is concerned only with the problem of *realizing* on the excess output. For Marx, the crisis is the violent periodic realignment of the balance between the three factors of surplus value, the rate of exploitation and technology so that a workable equilibrium is temporarily reestablished. Thus in Marx there is no theory of a cycle but a theory of an explosive spiral ending in communism. Any policy recommendations are futile and government, short of communism, cannot do more than referee the readjustment process since it cannot eliminate the class struggle.

If we place Marx on the scale of underconsumptionist thinking, he deviates in too many ways to be properly classified as an underconsumptionist. He shares the welfare concern of the underconsumptionist but he does not present a policy program for government in view of the inevitability of the processes he describes. In his emphasis on maldistribution of income and the accidental character of monetary problems and the disordering effect of the competitive principle he has some kinship to underconsumptionism.[55]

An anti-Marxian interpretation could, however, be made claiming that Marx sought to avoid underconsumptionism with its ultimate corrective policy of raising wages either directly or through taxation and expenditures, and that the falling rate of profit is the device by which Marx switches underconsumption into a completely different channel.

[54] This process is described in vol. 3, pp. 542–573, *Capital*.
[55] Hobson openly disavows Marx, particularly the labor theory of value and the Hegelian dialectic, in *Confessions of an Economic Heretic* (London: Allen, 1938) at pp. 35f where he says Marx "used an empty intellectual paradox to impart an air of mysticism into quite intelligible historic processes."

CHAPTER II

HOBSON'S LIFE AND INFLUENCES AFFECTING HIS ECONOMIC IDEAS

Born in Derby, England in 1858, John A. Hobson received his early education there and then went to Lincoln College, Oxford, where he studied the classics. After receiving his degree, he taught classics in the public schools, first at Faversham and later at Exeter for eight years from 1880 to 1887.

At the age of thirty, he left the classics and became an extension lecturer in English and Economics from 1887 to 1897. As Hobson himself says:[1]

> "It was not until the middle 'eighties that my economic heterodoxy began to take shape. Though the Henry George campaign against land values and the early agitation of various socialist groups against the visible oppression of the working classes, coupled with the revelations of the two Booths regarding the poverty of London, made a deep impression on my feelings, they did not destroy my faith in Political Economy."

Hobson's economic thinking may be broken tentatively and broadly into four periods:

1. The initial statement of underconsumption with A. F. Mummery in 1889.

2. The "independent" development of income maldistribution and the "right ratio" of spending to saving during 1891 to 1902.

[1] In a lecture before the London Ethical Society on July 14, 1935, reprinted in J. M. Keynes, *General Theory of Employment, Interest and Money* (New York: Harcourt, Brace, 1936) p. 365. This exact material does not appear in Hobson's *Confessions of An Economic Heretic* (London: Allen, 1938) which is more an *Apologia pro Vita Sua* than an autobiography.

3. A quasi-orthodox period from 1903 to 1918.

4. The resurgence of underconsumption and its practical application from 1919 to 1940.

While engaged in extension lecturing, Hobson wrote *The Physiology of Industry* with A. F. Mummery in 1889. Mummery was a successful business man who died in an Asian mountain climbing accident in 1895. It is quite possible that Mummery's influence dominates in this work. For example, there is present in the *Physiology* the only reference in any of Hobson's works to the importance of inventories in the crisis.[2] Likewise, there is an argument for protection[3] in terms of employment which does not recur in Hobson's writings until 1922.[4] Further, the concept of over-saving leading to failure of demand is presented with the approach of a businessman who has watched the flow of production and investment in a cross-section of industries and without the later analysis in terms of income maldistribution which Hobson added.

Hobson's attack on orthodox economics in the *Physiology* volume, particularly on the aggregative aspect of the virtue of thrift, rather definitely excluded him from an academic career in England in the field of economics.[5] During this period he also wrote *Problems of Poverty* in 1891 and *The Evolution of Modern Capitalism* in 1894. The latter has long been recognized as an important work in economic history.

During this period and earlier, Hobson was a close student of John Ruskin's works and throughout his life intensely interested in social reform in a broader sense than mere economic reforms. This factor plus his unorthodox position in economics led him to

[2] *Op. cit.*, pp. 132f *passim.* [3] *Ibid.*, pp. 206–209.

[4] *Economics of Unemployment* (New York: Macmillan, 1922), Appendix, pp, 146ff.

[5] As G. H. Cole states in "John A. Hobson, 1858–1940," *Economic Journal*, vol. 50, pp. 351–60 (1940). Hobson himself indicated he felt this was true. *Property and Improperty* (London: Gollancz, 1937), p. 171: "There is, of course, a selective process of appointment which would make it difficult or impossible to appoint a professor or lecturer in the social sciences known to be a socialist or an economic heretic."

Recently Terence W. Hutchison in *A Review of Economic Doctrines, 1870–1929* (Oxford: Univ. Press, 1953) suggests at p. 118 that Hobson lost academic employment through the activities of F. Y. Edgeworth. Hutchison cites in particular Edgeworth's acerbic review of *The Physiology of Industry* in *Education*, vol. 1 (1890), a short-lived journal.

write almost entirely for the popular reader, and in particular to turn out hundreds of articles in the English weeklies, particularly *The Nation*, in addition to fifty-three books. His interest in welfare economics culminated in his *Work and Wealth* in 1914. His concern with what ought to be rather than with mere analysis of what is stems from the influence of Ruskin. Similarly his emphasis on non-material development of society and his biographies of Ruskin[6], Cobden[7], Hobhouse[8] and Veblen.[9] Hobson's interest in ethics is illustrated by the following chapter headings of a total of sixteen chapters in his autobiographical *Confessions of an Economic Heretic*[10] written two years before his death in 1940:

> Humanism and Rationalism, Contacts with Political and Ethical Movements, The Rise of Sociology in England, The Welfare Economics of Population, Western Christianity, An Economic Journey Towards Humanism, The Revision of Democracy, and A Summary of Humanist Economics.

With the sociological study[11] of London's slums which appeared in 1891 and following the philosophy of Ruskin, Hobson focused on income maldistribution as a central thesis. There can be little dispute about Ruskin's impact on Hobson's thinking. Although what cursory mention is made of Hobson in most histories dates the income maldistribution concept from *The Evolution of Modern Capitalism*[12], the first real development of this question appears in *The Problem of the Unemployed*[13] in 1896. This small volume has been passed over by Haberler, Hansen and others in favor of chapters 3 and 18 of *The Industrial System*[14] of 1909 as the key statement of Hobson's thesis. The statement in *The Problem of the Unemployed*[15] is broader in two respects: (1) more detail in the sequence of the crisis, particularly the place of the rate of interest and money, and (2) consideration of phases of the cycle other than the crisis.

[6] *John Ruskin, Social Reformer* (Boston: Estes, 1898, 3d. ed., 1904).
[7] *Richard Cobden: The International Man* (New York: Holt, 1919).
[8] With M. Ginsberg: *L. T. Hobhouse, His Life and Work* (London: Allen, 1931).
[9] *Veblen* (London: Chapman, 1936). [10] *Op. cit.*
[11] *Problems of Poverty* (London: Methuen, 1891) 8 eds.
[12] London: Scott, 1894, rev. eds. 1906, 1916, 1926, 1938.
[13] London: Methuen, 1896. [14] New York: Longmans, 1909.
[15] *Op. cit.*, especially Chs. v and vi.

In 1899, Hobson went to South Africa as a newspaper reporter to cover the Boer War. The impressions made by this experience were very important and resulted in 1902 in *Imperialism,*[16] one of his most widely read works. Hobson viewed his theory of imperialism as a special case of the theory of underconsumption. The empirical verification he gained of the economic interpretation of imperialism and the close relationship to the matter of underconsumption left deep impressions.

From this time on, Hobson's life was divided between journalism, adult education as an extension lecturer, and economics. In each employment his emphasis was on reform.

In 1900, Hobson broke further with orthodox economics. In his *Economics of Distribution*[17] published in that year, he abides by conventional methods in treating economic theory, but generally attacks marginal productivity analysis. In his autobiography, *Confessions of an Economic Heretic*, he expresses keen disappointment that what he considered his most important discovery went unnoticed in professional economic circles. He referred[18] to his statement in *Economics of Distribution:*

> 1—"that in many markets, the volume of supply was restricted, naturally or artificially, so as to give the sellers, as a body, a superior bargaining force..."
> 2—"the selling price, even where 'free bargaining' prevailed, was determined in accord with the relative importance to... marginal buyers or sellers... the other buyers or sellers [getting]... a 'surplus' element."

It is difficult to understand why Hobson considered these as major "contributions". The second proposition is from Böhm-Bawerk[19] and original with Hobson only in the "surplus" concept. He appears to have imperfect competition analysis in mind here. Similarly all that is comprehended within the first proposition is recognized by others, e.g. in Marshall, particularly in the con-

[16] London: Allen, 1902. [17] New York. Macmillan, 1900.
[18] *Confessions of an Economic Heretic*, *op. cit.*, p. 168.
[19] And fallacious; price is not determined by marginal pairs but, after price has been determined, the marginal pairs exist. The specialized horse-market with auction or re-contract assumptions is the origin of the Böhm-Bawerk argument. Even then, every buyer or seller is marginal with respect to the last unit bought or sold.

cepts of consumers' surplus and producers' surplus and in the Webbs with regard to labor but with the buyer in the saddle.

Hobson believed that the lack of recognition accorded this book stemmed in part from its American publication. Rather, the lack of attention stems from the unoriginal character of the work which accepts Böhm-Bawerkian capital theory, refines Ricardian rent theory to recognize opportunity cost[20] and recognizes the substitutability of factors and the consequent mutual determination of factor-return.

Partly from his inability to secure an academic appointment and partly from the lack of recognition of the *Economics of Distribution*, Hobson from this date forward substantially reduced the references in his works to any academician or his writings.

It was also at this time that Hobson became embroiled in a series of articles[21] stemming from his statements in *Economics of Distribution* questioning the validity of marginal productivity theory. The upshot of Hobson's position is that he refuses to recognize a distinction between the so-called specific marginal productivity theory and the non-specific approach and that he attacks the entire marginal concept.[22]

In the period from 1902 to 1919, underconsumption appears to be dormant in Hobson except for *The Industrial System*. To what extent this originates with the continuously rising price level of this period in England is a question. The period marks a retreat from the view of the international financier as the *diabolus machini* in *Imperialism* to the hopeful recognition, in *An Economic Interpretation of Investment*,[23] of the role that the banker, the governor of imperialism, can play as the tool of international peace. Likewise, in *Gold, Prices and Wages*[24] in 1913, the inflation question is approached via criticism of the tautological character of the transactions equation of the quantity theory of

[20] First developed by Hobson in "Law of the Three Rents," *Quarterly Journal of Economics*, vol. 5, pp. 263–88 (1891).

[21] "Marginal Units in the Theory of Distribution," *Journal of Political Economy*, vol. 12, pp. 449–72 (1904).
"Marginal Theory of Distribution: A Reply to Professor Carver," *Journal of Political Economy*, vol. 13, pp. 587–90 (1905).
"Marginal Productivity," *Economic Review*, vol. 20, pp. 301–10; 673–86 (1909).

[22] The argument about the validity of marginalism is developed, *infra*, Ch. VI.

[23] London: Financial Review of Reviews, 1911. [24] London: Methuen, 1913.

money. Hobson develops this volume within the traditional framework of price-effects rather than output-effects. Except for this volume, Hobson shows slight interest in the monetary problem. Even in *The Industrial System* in 1909, the underconsumption argument is confined to two chapters and presented primarily in terms of the "right ratio of spending to saving" with lesser emphasis on income maldistribution.

The renascence of underconsumption begins with *Taxation in the New State* in 1919[25] in which Hobson goes back to his original concept of "surplus" (payment to a factor in excess of what would be necessary to draw that factor into production) as the source of saving and the proposition that the bulk of surplus so defined accrues to capital. He develops a theory of taxation from the proposition that the nearest "surplus" must be the point of incidence of any tax. An obvious relation then appears between the size of the tax and the volume of saving which in turn is determinative of underconsumption.

With the post-World War I difficulties of unemployment in England, Hobson follows the underconsumption analysis through the practical questions of reparations in *The Economics of Reparations*,[26] wage policy in *The Economics of Unemployment*,[27] rationalisation of industry in *Rationalisation and Unemployment*[28] and foreign trade policy in *Property and Improperty*.[29] The entire period from 1919 to Hobson's death in 1940 represented varying degrees of unemployment in England. During the period, Hobson likewise consistently and affirmatively adhered to the underconsumptionist principle.

Hobson had no severe training in economic theory, but his books cite the works of Smith, Ricardo, Marshall, McCulloch, Mill, Marx, Jevons, Say, J. B. Clark, Böhm-Bawerk, Hawtrey, Ely, Keynes and others among economists, and such economic historians as Ashley, Baines, Defoe, Sombart, Toynbee, Ure and others. Most of these references are in his pre-1900 books. Significantly absent from citation are the underconsumptionists Sismondi, Lauderdale, Malthus and Rodbertus, except for some reference to Malthus in *The Physiology of Industry*, *The Evolution*

[25] London: Methuen, 1919. [26] London: Allen, 1921.
[27] New York: Macmillan, 1922, rev. ed., 1931. [28] London: Allen, 1930.
[29] *Op. cit.*, Ch. III.

of Modern Capitalism, and *Confessions of an Economic Heretic*. There is, however, a pregnant reference to Malthus and Lauderdale in the preface to *The Problem of the Unemployed*.

Keynes has perhaps correctly summarized matters in 1913 when he says:[30]

> "One comes to a new book by Mr. Hobson with mixed feelings, in hope of stimulating ideas and of some fruitful criticisms of orthodoxy from an independent and individual standpoint, but expectant also of much sophistry, misunderstanding, and perverse thought."

This is the same Keynes who was to write in 1936 of Hobson's first book, *The Physiology of Industry*:[31]

> "Though it is completely forgotten today, the publication of this book [*The Physiology of Industry*] marks, in a sense, an epoch in economic thought."

The prolific writings of Hobson cover a wider range of knowledge than economics and biography, extending to philosophy, sociology and political theory. His works in economics, with a few exceptions, are not in the rigorous tradition, but maintain frequent distractions and excursions. In addition, there is much ellipsis and a study of his system assumes the aspect of a giant jig-saw puzzle.

He travelled widely after his South African trip, including the American continent, and his experience gained in these trips served very often as the immediate touchstone for a book.

SUMMARY

Hobson was more interested in current problems and more of a controversialist than most economists. His perverse attitude to academicians led to a disdain for the presentation of a complete system; rather he presents only such theory as is necessary to an

[30] Review of *Gold, Prices and Wages*, *op. cit.*, in *Economic Journal*, vol. 23, p. 393, in 1913.

[31] *General Theory of Employment, Interest and Money* (London: Harcourt, Brace, 1936), p. 364.

immediate problem. As a controversialist, he meets opposition on its own grounds,[32] though *elsewhere* he indicates that he does not accept his own argument from a larger analysis. Likewise, because of his concern for policy and for effectiveness of his principal arguments, he will omit conditions and qualifications whose validity he recognizes *elsewhere*. The last is the most disturbing to an academician—and may have been deliberate.

[32] E.g., *Gold, Prices and Wages, op. cit.*, as developed *infra*, Ch. VI, § 4a.

CHAPTER III

HOBSON'S FIRST STATEMENT OF UNDERCONSUMPTION

1. THE HOBSON-MUMMERY ARGUMENT

It is quite possible that Hobson's co-author, A. F. Mummery, was more responsible for *The Physiology of Industry*[1] than Hobson. At least it is difficult to explain on any other hypothesis some of the shifts of position[2] which occur within a few years in *The Problem of the Unemployed*[3] and *The Evolution of Modern Capitalism.*[4]

In the preface to *The Physiology of Industry*,[5] saving (taken as identical with investment) is viewed as an increase in capital and a simultaneous reduction in consumption such that an excessive accumulation of capital "will exist [sic] in the form of general over-production." Hence the proposition that[6] "Consumption limits production and not production consumption."

[1] London: Murray, 1889.

[2] For example, in *The Physiology of Industry*, the essential argument (p.v.) is that "any undue exercise of this habit (of saving) must, therefore, cause an accumulation of Capital in excess of that which is required..." but in his *The Evolution of Modern Capitalism* (London: Scott, 1906), p. 263 the argument is that monopolistic profits cause the contracted demand for commodities and "If competition were displaced by combination of a genuinely co-operative nature in which the whole gain of improved economies passed either to the workers in wages, or to large bodies of investors in dividends," there could be no inadequacy of demand. Maldistribution replaces oversaving per se as the causal factor. This and other indications noted below, argue for the importance of Mummery in the first work.

[3] London: Methuen, 1896. [4] London: Scott, 1906. [5] *Op. cit.*, p.v.

[6] *Ibid.*, p. vi. Hobson sometimes fails to separate two meanings of "capital": (1) all non-consumed goods, (2) capital goods or means of production. Neither is he careful to distinguish (1) the real value of capital goods and (2) the money value of capital goods.

The logic of events is more fully developed later:[7]

> "If increased thrift or caution induces people to save more in the present, they must consent to consume more in the future. If they refuse to assent to this condition, they may persist in heaping up new material forms of capital, but the real effective capital will be absolutely limited by the actual extent of their future consumption."

While Hobson distinguishes[8] between "quantity demanded" (defined as "the aggregate bought") and "demand" (defined as "the quantity of purchasing power applied to purchase the quantity demanded") he has no concept of a schedule or function. He apparently intends to carry the distinction made in microeconomics over to macroeconomics,[9] thus dropping price as the connecting link but not always bringing out that he is substituting income as the new link.[10]

Although the concept of a schedule or function is missing, the acceleration principle is recognized.[11] Thus Hobson argues that a 10% increase in annual consumption at full employment requires a 50% increase in total output, including capital goods, but once the goods are built there is a permanent increase in consumables although a substantial reduction in total annual production effort needed. Hence[12]

> "No matter how much capital may be available for use, the inducement to use it depends exclusively on the demand for commodities, and if this demand decreases, a force is set in operation which, working through price and profit at each stage in the process of production decreases the quantity of forms of capital in existence."

Excessive capital (idle capital goods and unconsumed consumers' goods) is described in these terms:[13]

[7] *Ibid.*, p. 51. [8] *Ibid.*, p. 58.
[9] This shift from micro to macro is brought out in various ways, e.g., *ibid.*, p. 77: "While the community is unable to consume capital—the individual suffers from no such disability."
[10] Thus, *ibid.*, p. 110: "Our law of Quantitative Relation asserted a fixed relation between the Amount of Present Production and the Amount of Future Consumption."
[11] *Ibid.*, pp. 85, 86. [12] *Ibid.*, p. 88. [13] *Ibid.*, p. 96.

> "—depression may be defined as a general reduction in the rate of incomes—a decrease in the quantity of the uses of the requisites of production demanded relatively to the supply available—which is caused by a fall in consumption—The only cause, however, which can lead to an insufficiency in consumption is the undue exercise of the habit of thrift or saving..."

The question, then, becomes what causes the habitual tendency to over-saving. Even on the assumption that the rate of consumption remains the same, "the amount of effectual saving which could be stored in forms of capital would continually diminish"[14] due to improved technology. Secondly, competition between individuals leads to oversaving. While this is not fully spelled out in *The Physiology of Industry*, the argument centers around the existence of consumers' surplus. Consumer goods exchange at a price less than their "true value" to the consumer and this leads to automatic saving with saving having a higher marginal utility than further consumption regardless of the rate of interest. This last argument is in open conflict with the later Hobsonian argument that sellers are always in the saddle, which dates from the *Economics of Distribution* in 1900.

The classical answers to these objections of Hobson are: (1) that the general price level will fall under such conditions, leading to increased consumption, and (2) the rate of interest will fall causing production to increase.

In answer to (1), Hobson argues that over-capacity caused by over-saving results first in a fall of wholesale prices and only at a later date do retail prices fall after money incomes (not necessarily real incomes) have first been reduced. "The paradox" that a community can only increase its consumption by first increasing its saving is "avoided" because money income "is not only affected proportionately by every rise of price, but also by the increased number of times the higher price is paid, that is by the increased number of sales."[15] That there can be both an increase in consumption and an increase in saving is explained by this process:[16]

[14] *Ibid.*, p. 116. [15] *Ibid.*, p. 127. [16] *Ibid.*, p. 128.

> "If some do not do their share of saving—they are thereby increasing the possibility of effective saving for others who are less extravagantly inclined and will force the latter to save a larger proportion of their incomes by the incentive of a rise in profit until the less extravagant are induced not only to do their share of the necessary saving, but the share which the more extravagant refused to do."[17]

Conversely, depression need not result if the community should seize the opportunity of a general fall of retail prices caused by over-supply to increase the rate of consumption. But "paying regard to the ordinary motives that operate with men", there is no reason to hope that a fall in retail prices, which brought with it a corresponding fall in money incomes, would operate in this way.

Thus he rejects the Pigou effect.[18]

In answer to (2) (the classical fall in the rate of interest), Hobson identifies "interest" and "profit" and proceeds as follows:[19]

> "If a fall of Profit is to induce people to save less, it must operate in one of two ways, either by inducing them to spend more or by inducing them to produce less."[20]

Whether rich or poor, there is no reason to believe they will spend more since the bulk of saving is not a function of the interest rate. The second is the actual alternative: lower incomes following on lower production are the cause of lower saving. To suppose that lower profits are the cause of lower saving is to argue[21] that "falling profit is the immediate cause of the very malady which it is supposed to prevent."

Hobson then appeals to history to illustrate his argument. The Franco-Prussian war of 1870 presents a case of a sudden increase

[17] Hobson distinguishes the situation after full employment is attained (*ibid*): "It must, of course, always be borne in mind that as soon as all the labourers available for work are fully employed, or as soon as all the natural agents available for use are fully used, no further increase in consumption or in capital can take place... In this case consumption will be limited by production, and can only increase if the number of labourers increases, or if advances in the mechanical arts enable the existing number of labourers to effect the production of a larger quantity of wealth."

[18] *Ibid.* [19] *Ibid.*, p. 130.

[20] He does not recognize the possibility of an increase in idle balances.

[21] *Ibid.*, p. 132.

in total consumption for war purposes and a decrease in production due to the reduction in labor force through the absence of soldiers. "Saving" occurs when people are willing to lend money to the Government with which purchases are effected while capital goods output falls. Manufacturers gain at the expense of traders and the rise in wholesale prices is thus explained. There is a great demand for capital goods. No post-war collapse followed in 1873[22] because savings were spent for new plant. Oversupply did not immediately result because no expectation of glut existed and many of the plants were not yet finished. A series of bubble companies sustained the picture by taking savers' money and spending it in consumption. Gradually savings' outlets vanished and people put their savings into banks which eventually saw accumulating goods and called loans. Meanwhile, traders saw the increase of goods in storage and lowered their bidding prices, wholesale prices fell and traders' profits rose. Trading then drew the investment attention and increased competition among retailers did not lower price but divided the old profits among more traders.

Retail prices fundamentally do not fluctuate as much as wholesale because in addition to this competitive development in trading, consumers do not carry fluctuating inventories but retailers do.[23] In addition, consumers do not note price and quality differences as quickly as retailers. Further, a fall in prices relative to incomes does not induce the usual man to increase consumption, but a price rise relative to incomes will cause him to cut consumption because he is living just within his income. Hence the same factors of production produce more goods when there is a high rate of consumption accompanying the greatest possible rate of production but less goods when the rate of consumption is lower.

> "Thus the difference in the rate of incomes of the community at the height of prosperity and the lowest depths of the depression was exactly [1870–80] represented by the difference in the amount of commodities produced and consumed relati-

[22] Hobson apparently considered the panic of 1873 as largely confined to the United States and as monetary in essence.

[23] This reference to inventories apparently originates with the business-man Mummery since it does not later enter into Hobson's argument.

> vely to the quantity that could have been produced and consumed."[24]

Regarding the relative position of the factors through the cycle, the argument is as follows: "the scarcest factor at the time of expansion of consumption receives the largest reward."[25] This is at first usually capital which is the least adaptable. Hence in this period labor gets little of the benefit of machine improvements. Later, as expansion continues, the roles of capital and labor exchange relative position. Then in depression, because of reduced consumption, workers are dismissed and "the rate of wages is fixed at the point at which even unemployed labourers cease to compete further; and, as we have seen, this point is determined wholly irrespective of the more or less of the ultimate product, and exclusively by the more or less desirable alternative methods of subsistence open to this unemployed surplus."[26]

Final application of the argument is made to classical free-trade[27] which assumes that what can be produced will be consumed. On this assumption, protection will lessen possible production and reduce consumption. But if the assumption is invalid, a protective tariff would increase the costs at the lower stages of production and draw to the lower stages, i.e., manufacturing, resources congesting higher stages, i.e., merchandising.

2. EVALUATION OF HOBSON-MUMMERY ARGUMENT

The Hobson-Mummery argument has several primary idiosyncrasies:

1. It does not recognize even a possible role for the rate of interest.

2. It argues that excessive saving causes immediate *actual* accumulation of capital (total of capital goods plus unconsumed goods) in excess of requirements, whereas it may be the *attempt* to save more than the equivalent of required capital (total of

[24] *Ibid.*, p. 170. [25] *Ibid.*, p. 181. [26] *Ibid.*

[27] *Ibid.*, p. 206–209. The significance of the protection argument for world-wide unemployment cases, Hobson did not see until 1922 as pointed out in Ch. IV below.

capital goods plus unconsumed goods) which is the cause of income changes. In short, there is no ex ante, ex post distinction.

3. As a consequence Hobson's later books develop the theory that underconsumption leads to unprofitable expansion of means of production rather than the argument of the *Physiology* that the reduced consumption requires but is not followed by new investment which is prevented by the fall of the expected profit below that required by the rate of interest.

4. Maldistribution of income is not vital to this first explanation of the cause of over-saving.

5. This first statement does not attempt any development of the determinants of the "right ratio" of saving to consumption or of the process of adjustment from oversaving to the "right" amount of saving.

6. There is no more than an explanation of the crisis period of the cycle.

The detailed development of the significance of these weaknesses, as well as the correction of some of them in later Hobsonian writings, is left to Chapter VI.

CHAPTER IV

THEORY OF IMPERIALISM AS AN APPLICATION OF UNDERCONSUMPTION

1. GENERAL STATEMENT

After the initial consideration of underconsumption in *The Physiology of Industry*[1] and *The Problem of the Unemployed*,[2] Hobson worked on his *Economics of Distribution*[3] and *The Evolution of Modern Capitalism*.[4] Then followed the original edition of *Imperialism* in 1902. This does not contain the twenty-page introduction which Hobson added to the 1938 edition.[5] This introduction vigorously establishes the relationship of the theory of imperalism to underconsumption principles. That relationship is only sketched in the original edition. The inhumanity of political activities draws more focus in the original.

Hobson's experience in serving as a correspondent in the Boer War actually was the immediate stimulus to his development of the theory of imperialism as an application of his theory of underconsumption.

2. DEFINITION OF IMPERIALISM

The term "imperialism" is used in various meanings. The Hobsonian definition has its own special scope. Imperialism is distinguished from Nationalism, Colonialism and Internatio-

[1] Cf., *supra*, Ch. III. [2] London: Methuen, 1896.
[3] See the discussion of this work, *supra*, Ch. II.
[4] London: Scott, 1894, rev. eds., 1906, 1916, 1926, 1938. So far as this work considers imperialism, it is handled in this chapter; so far as it serves as the fore-runner of further development of underconsumption, particularly *The Industrial System* (New York: Longmans, 1909), it is considered in Ch. VI.
[5] *Imperalism* (London: Allen, 1902, rev. ed., 1938). References are to 1938 ed.

nalism. Its essence consists of political and economic control over territories outside the mother-country. The concept involves competing empires:

> "...Imperialism, is the combined or separate action of capital to obtain the help, financial, diplomatic, military, of the national government so as to secure preferential access to foreign markets and foreign areas of development by colonies, protectorates, spheres of preferential trade and other methods of a pushful economic foreign policy."[6]

This by definition excludes "socialistic" imperialism.

Imperialism would become "Interimperialism" if the several "empires" would unite to develop a backward area. Such "empires"[7] include the United Kingdom, France, Germany (pre-World War I), Netherlands, Portugal, Russia, Turkey, Japan (post-World War I) and the United States.

3. BIBLIOGRAPHY OF HOBSON'S THEORY OF IMPERIALISM

Hobson's theory of imperialism is found primarily in five of his published volumes.

In *Imperialism* the primary arguments concern (1) foreign capital investments by mature economies in hinterland countries as an outlet for excess savings and to develop markets and (2) internal development within the mature economy of trusts—or as Hobson says, trustification.[8]

International Trade: An Application of Economic Theory[9] is an adaptation of classical international trade theory to incorporate the changes involved in Hobsonian underconsumptionism, but with no theoretical advance over *Imperialism.*

An Economic Interpretation of Investment[10] is primarily a development of the logic of economic gain to both debtor and creditor

[6] *Ibid.*, pp. xix, xx.
[7] *Ibid.*, p. 23.
[8] *The War in South Africa* (London: Nisbet, 1900) and *The Psychology of Jingoism* (London: Richards, 1901) are more popular statements by Hobson of the same material covered in *Imperialism.*
[9] London: Methuen, 1904. [10] London: Financial Review of Reviews, 1911.

countries from foreign investment. This is a partial retreat from *Imperialism.*

The New Protectionism[11] is an evaluation and itemized rejection of the many arguments developed by Protectionist theory.

Canada Today[12] is largely a travelogue, but considers Canadian experience with foreign investment.

The first volume, *Imperialism*, states all the elements of Hobson's theory of imperialism, and is rightly regarded as the most important of these volumes. Accordingly, the logic of presentation adopted in *Imperialism* is followed in this study.

4. HOBSON'S THEORY OF IMPERIALISM BRIEFLY STATED—ITS PREMISES

Hobson recognizes that the economic interpretation of history is not a complete interpretation, but he emphasizes it: "Though considerations of political acquisition, colonial settlement and missionary services, have been conscious supports, economic motives of trade and the exploitation of natural resources have been the dominant urges"[13] of a policy of imperialism.

Hobson summarizes his theory of imperialism in the introduction. Imperialism is required (1) to furnish markets for the excess production in the mature countries over the effective demand of home markets for consumption, and (2) to furnish the larger home requirements for raw materials and imported foods which follow from industrialization, and can be paid for only by increased export of finished goods or income from foreign investment through the earlier export of capital goods. The first factor he terms "the most potent drive" of imperialism.[14] The need for markets arises because of a chronic tendency of the economy to over-save, that is, to invest in more production facilities turning out more goods than the remaining income for consumption can absorb at prices sufficient to enable the recovery of the investment.

[11] New York: Putnam's Sons, 1916. [12] London: Unwin, 1906.

[13] *Imperialism, op. cit.*, p. ix.

[14] *Ibid.*, p. vi. However, in *The Evolution of Modern Capitalism, op. cit.*, 1906 ed., p. 262, primary emphasis is placed on imperialism as an outlet for excessive profits from "trustification."

Hobson immediately meets the classical objection that any tendency to over-save automatically is checked by the price mechanism operating through a lowering of the rate of interest by arguing that while interest rate changes ration investment funds among investment opportunities, *they do not "operate to any appreciable extent to increase or diminish the total volume of saving*." Rather, the corrective check on saving comes too late in the form of a depression, which brings about (through default in rents, dividends and interest, and through losses of principal) a fall in the net rate of saving below what is needed to maintain a normal output of consumption goods. This "folly", as he describes it, is not due to the action of individual savers, but to an income distribution which puts too small a share in the hands of the working classes and too large a share in the form of rents, dividends and interest into the hands of employers. Practically all saving is from rent, dividend and interest income. This follows the argument which first appeared in 1896 in *The Problem of the Unemployed*.

In the general statement of his thesis, Hobson denies that the following propositions are necessary to his theory of imperialism: (1) that modern wars are exclusively or even primarily caused by imperialism,[15] or (2) that the removal of all barriers to international trade and migration would at once assuage hostilities and restore prosperity.[16]

The latter remedy, which is essentially free trade, can be held, he argues, only by those who believe nationalistic sentiments are the real source of the economic policy of imperialism, or by those who believe that monetary disturbances are that source. An underconsumptionist sees that such a remedy can only palliate and not cure the basic problem of the consumption-saving ratio.

Over-saving results in pressure for tariffs, embargoes, subsidies, colonial and other devices to provide and protect the outlets for increased productive power. In this connection, the trades "directly or indirectly connected with the production of arma-

[15] Herein Hobson differs from Lenin, as will appear below. Aside from this difference, Lenin adopted the Hobsonian theory of imperialism *in toto*. It is somewhat academic to try to determine whether Lenin or Hobson placed more emphasis on the savings outlet argument or the market development argument. Both men recognize both arguments.

[16] *Imperialism., op. cit.*, p. x f.

ments have a two-fold function": 1) to increase public expenditures on arms at home, and 2) to evoke, as a result, increased armament expenditures abroad. Armaments thus provide part of the increased market outlet needed for the increased productive power—an increase in markets which is in addition to the foreign markets immediately provided by imperialism. In addition, war itself consumes the surplus of goods that might otherwise pile up after even these markets have been exhausted. To justify this interpretation of war, it is not necessary to show that the whole economy gains from war, which it admittedly does not, but only that the group controlling the economy so profits.[17]

This leads finally to Hobson's proposed solution:[18] the elimination of the competitive price system which does not distribute goods on a true value basis (defined as a barter economy exchange ratio).[19] Although Hobson does not use the terms "consumers' surplus" and "producers' surplus," he has in mind the Marshallian concepts. Herein, Hobson claims, lies the error of a system where goods pass from one person to another at other than their true values to the parties, except in the case of the marginal pairs who are the only ones to trade at true values under the competitive price system.[20] While Hobson does not spell it out, he *infers* that this results in a lesser ratio of total consumption to income than if *each* unit of product moved at its "true" value, and that income maldistribution heightens the result just indicated.

Short of a radical elimination of the competitive price system, a policy of concessions to labor and extensions of social services by government may prove a workable compromise. Hobson is quick to recognize the importance of incentive to progress and therefore recognizes the necessity of leaving "the newer industries," as he calls them, outside the scope of state planning. But

[17] The identity of the economics of Hobson's theory of imperialism with neo-Marxian theory is brought out in Ch. xvii of Paul M. Sweezy, *Theory of Capitalistic Development* (New York: Oxford, 1942).

[18] *Imperialism, op. cit.*, p. xvii.

[19] Competitive price and "true" value diverge for all units purchased where

$$\frac{\text{marginal utility of one good}}{\text{price of that good}} \neq \frac{\text{marginal utilities of every other good}}{\text{prices of such goods}}$$

for each individual *and for each unit purchased by each individual.*

[20] But this would be true only of the marginal unit of the marginal pairs.

an even greater difficulty to a workable compromise or mixed economy is, for Hobson, the nature of the replacement for "financial control over big industry which is the latest fruit of the capitalist evolution." Hobson acknowledges the important functional role of the financier who is responsible for efficiency in the economy even though his guiding principle is maximization of profits rather than maximization of output or total satisfaction. The principle of maximization of profits leads to the establishment of trusts and restriction of output particularly in those cases where the elasticity of demand for the product is lower than unity.

Hobson summarizes the methods of cure possible within a mixed economy:[21] (1) the program of organized labor and of the State to procure more equal distribution of income, (2) the program of business to restrict output and regulate markets and investments, and (3) the expansion of the existing program of imperialism to provide markets among the "have-not" nations for the "have" nations.

From the viewpoint of the 1938 revision of *Imperialism*, Hobson finds the least possibility in (3), but there is enough to be gained by the owning class from such a policy that it will continue as a conflict within democracy and as a prime tool where the economy is not democratic but under the control of an oligarchy.

5. THEORY OF IMPERIALISM AS AN APPLICATION OF UNDERCONSUMPTION

Hobson viewed his theory of imperialism as an application of his general theory of underconsumption. It is not easy to state this theory briefly. Late in his career, Hobson was content to stand by a rather naked statement of Say's law,[22] recognizing only the aspect of maldistribution of incomes in real terms and passing over a shift in liquidity preference schedules of all individuals as being a consequence of the crisis. Hobson never attached much importance to—and it can fairly be said that he never really recognized—the concept of liquidity preference,[23] nor the role of

[21] *Imperialism, op. cit.*, p. xix.
[22] *Rationalisation and Unemployment* (London: Allen, 1930), p. 33.
[23] Defined as the demand for cash rather than securities as a function of the money interest rate.

the banking system in the trade cycle and the role of the rate of interest.[24] In short, Hobson's theory concentrates on maldistribution between saving and consumption arising from unequal distribution of income in the traditional shares. He argues there is a tendency to save an increasing percentage of income the higher the individual's income and the more mature the economy. These tendencies, together with diminishing investment opportunities, create depression. In considering diminishing investment opportunities less emphasis is placed on the diminishing marginal efficiency of capital and more on the shrinking market resulting from over-saving.

6. ANALYSIS OF LOGIC OF HOBSON'S THEORY OF IMPERIALISM

The book of 386 pages constituting *Imperialism*, after an introductory chapter, is divided into two parts: (1) the first 97 pages on "The Economics of Imperialism" and (2) the balance on "The Politics of Imperialism". Our brief statement is based on the 20-page Introduction which contains the complete logic.

Aside from the qualifications already pointed out in the preceding section upon Hobson's theory of underconsumption, there are questions about the premise that an economy chronically tends to over-save, i.e. to over-invest in productive facilities. For Hobson, saving and investment are the same thing, until after the crisis and with the exception of money saved by one person and lent to another for consumption purposes. Over-saving results in turning out more goods than the remaining (uninvested) income can consume at prices sufficient to enable the recovery of the investment. This premise Hobson rests on two propositions. The first is that there is a "right" amount of saving out of a given income, which will maintain equilibrium in

[24] Passages can be quoted from Hobson's works showing that he understood the credit-rationing effect of the banking system during the later stages of a boom in particular. And, understanding this, Hobson might be expected to develop insights with respect to the role of liquidity. He did not, however. Indeed, it can be argued that all Keynes did to the Hobsonian system was (1) increase the systematization, (2) integrate liquidity preference into the theory, (3) develop the theory of other parts of the cycle besides the crisis and (4) develop the role of the rate of interest.

the economy. This ratio is fixed only when the rates of the usual parameters are fixed, e.g., population, technology, etc. The second is that almost all saving comes from rent, dividend and interest.

The logical difficulty with the first proposition is great. Hobson insists that this proposition is vital to his system. He does not recognize the possibilities of varying proportions of capital and labor, but operates with fixed production coefficients in mind. In fact he largely passes over the deepening of capital on grounds of rapidly changing technology and rapidly changing consumtion patterns. He does not consider the possibility that the larger the saving (investment) from current income, the less the danger of ultimate glut of consumer goods because of the greater loss of capital due to an increased rate of technological change; in short, that technological change can act in the same capacity as war in destroying excessive saving.[25] He considers over-investment as primarily duplicative (widening of capital) rather than deepening.

Hobson may be right in arguing that "there must be a definite quantitative relation between the rate of production and the rate of consumption"[26] (abstracting for the moment from the serious problem of inventories, to which he directs no attention) but when he adds "or in other words, between the quantity of employment of capital and labour and the quantity of commodities withdrawn from the productive stream within any given time" he illustrates the defects which we have just noted; namely, a broad *ceteris paribus* assumption which cannot be justified, particularly when the factors included in the assumption are liquidity preference, the interest rate and other matters already pointed out.

Thus, without altering the *practical* apparatus of the Hobsonian theory of imperialism, the order of causation may be reversed!

[25] He gives passing recognition to this argument in *The Industrial System* (London: Longmans, 1909), p. 52: "But while it thus might seem that the opportunities for useful saving were infinite, i.e., that any proportion of the current general income could serviceably be saved provided that at some distant time society increased correspondingly its rate of consumption, this is not truly the case..." because the changing arts 1) "very soon result in promoting an increased flow of finished goods," and 2) "the proportion of new saving which can be so applied to fructify at some far distant date is necessarily small, restricted principally by our inability to forecast far ahead either the needs of coming men or the most economical modes of providing for them."

[26] *Ibid.*, p. 41.

Rather than pent-up savings and overrunning production at home seeking outlets abroad, the causation may be the superior investment opportunities abroad offering higher profits and increasing home consumption, thereby raising the home standard of living.[27] Hobson recognizes this as partly true[28] in *Imperialism* but considers it as subordinate—a by-product.

Similarly, the second proposition supporting the oversaving premise of Hobson's theory of imperialism—that the great bulk of saving comes from rent, dividends and interest—is suspect.[29] Internal saving by business firms does not show as consumption potential in distributive shares.[30] Large portions of saving are by shares which can hardly be classed as surplus. Events of the last fifty years have changed the traditional pattern of income distribution assumed by Hobson[31] and the shift in standard of living has likewise enabled new classes to save to the point where the factual basis upon which Hobson rested his surplus argument is no longer so secure. His thesis, however, could be supported by arguing that the rate of saving has not changed though the composition of savers is different.

The question still remains whether as an economy grows more mature it does not over-save. Hobson correctly sees that the vital argument centers around the role of the rate of interest at this juncture. He rejects the classical argument that the rate of interest falls or rises to adjust the supply of saving to the demand for investment funds, claiming that savers will not stop as the interest rate falls. But even assuming inelastic supply of loanable funds, the greater part of the classical argument about the role of the rate of interest remains unanswered. Without arguing that savers are discouraged, a fall in the rate of interest may make feasible a *large* increase in the amount of profitable investment—

[27] This matter was recognized by Hobson in his first work, *The Physiology of Industry*, *op. cit.*, p. ix, but then it appears to have disappeared from his thinking to be rediscovered in 1922 in *Economics of Unemployment* (New York: Macmillan, 1922), Appendix.

[28] *Imperialism*, *op. cit.*, p. vi.

[29] This matter is considered in the section on underconsumption, Chap. VI below.

[30] Hobson himself later recognized this factor in 1930. *Rationalisation and Unemployment*, *op. cit.*, p. 28.

[31] The statistical basis for this proposition appears in the section on underconsumption, (Ch. VI), referring particularly to changes since the Great Depression.

in short the question remains as one of the elasticity of the demand curve for money for investment. Hobson implies or assumes that it is quite inelastic.

We have not yet come to grips, however, with the basic tenet of the Hobsonian system. Hobson argues in his autobiography[32] that his most significant contribution was the discovery of

> "two salient truths: first, that in many markets the volume of supply was restricted, naturally or artificially, so as to give the sellers, as a body, a superior bargaining force for the sale of their goods, reflected in a higher price than was economically necessary to evoke their productive services. Secondly, the selling prices, even where "free-bargaining" prevailed, were determined in accord with the relative importance to certain buyers or sellers of effecting a purchase or sale: these marginal buyers or sellers fixed the price at a point where it was just worth their while to buy or sell, the other buyers or sellers got from this price something more than would have been a sufficient inducement, i.e., a "surplus" element."

While this is the fallacious[33] Böhm-Bawerk argument of marginal pairs, Hobson is drawing other social and welfare conclusions. From this basis Hobson argues:

> "If a tendency to distribute income or consuming power according to needs were operative, it is evident that consumption would rise with every rise of producing power, for human needs are illimitable, and there could be no excess of saving."

This solution and the statement of the problem overlook the importance of money and its characteristics of liquidity. But more important, he overlooks deepening of capital and other aspects already indicated. Every buyer or seller is marginal with respect to his last unit and thus the same problem would exist even aside from the marginal pair fallacy.

[32] *Confessions of an Economic Heretic, op. cit.*, p. 19.
[33] Marginal buyer and seller do not determine price. Rather, after every price is determined we find a marginal buyer and seller. This Hobson later recognized in *The Industrial System* (New York: Longmans, 1909), at p. 102.

The valid part of this statement by Hobson lies in the first proposition that under modern conditions, sellers as a group possess superior bargaining power,[34] rather than in the second proposition. The maldistribution argument can be rested on the superior position of sellers under modern economic organization, but to the extent that the second proposition attempts to add anything, (assuming buyers and sellers have *equal bargaining power*) there is no reason to believe over-saving will result where human wants are assumed illimitable.

Since the mother country is the selling country, Hobson can use the first proposition as a basis for his theory of imperialism.[35]

Hobson has summarized[36] his theory and solution of the imperialist problem by an analogy of "intensive versus extensive cultivation." "A rude or ignorant farmer" when land is plentiful is apt to spread his capital and labor over a large area (the foreign markets) whereas a "skilled scientific farmer" will cultivate less land more intensively for the most remunerative markets (the home markets). The true answer, of course, is to exploit both extensively and intensively to the point of equal returns at the margin. Hobson does not recognize this principle in his theory of imperialism.

7. ANALYSIS OF THE EVIDENCE USED BY HOBSON TO SUPPORT HIS THEORY OF IMPERIALISM

After a consideration of the measure of imperialism via a comparison of the square-mile area and population of "colonial" or dominated territories held by each of the Western powers, Hobson totals the figures as of 1900:

[34] This is not to imply that Hobson would dispute that *buyers of labor* have superior bargaining power.

[35] There is a chapter (V) on "Hobson and the Theory of Economic Imperialism" in E. M. Winslow, *The Pattern of Imperialism* (New York: Columbia Univ. Press, 1948) pp. 92–110, an effort which shows a good grasp of Hobson's economics. Tracing the foundations of the theory of imperialism is attempted by Charles Conant, *The United States in the Orient* (Boston: Houghton Mifflin, 1900) but it appears that the Hobsonian theory is directly attributable to the initial over-saving thesis in *The Physiology of Industry*, *op. cit.* and the journalistic experience of Hobson in South Africa in 1899 during the Boer War, which is the source Hobson claims for this theory. Cf. *Imperialism*, *op. cit.*, preface and *Confessions of an Economic Heretic*, *op. cit.*, pp. 59, 62.

[36] *Imperialism*, *op. cit.*, p. 92.

	Square miles	Population
Mother countries	15,813,201	850,103,317
Colonies, etc.	22,273,858	521,108,791

Hobson admits there is no *necessary* limit to the capital and labor that can be used in the home markets *provided* income is distributed so that every increase of production stimulates a corresponding increase of consumption. The value of colonies to a country thus is not the total goods sold abroad but the gain from selling them abroad compared to selling them at home.[37] As a nation attains high development, an increasing part of its production goes into higher types of product which are less adapted for trade with lower level countries. Britain passed the peak of such imperialistic trade just after 1900 when her internal trade started to grow faster than her foreign trade. From 1875 on, British colonies started to carry on an increasing percentage of their trade with countries other than the mother country while the trade with the mother country remained stationary, and mother-country trade with other mother countries increased.

Hobson cites all this to distinguish true imperialism from *colonialism.*[38] This further shows in the increase in Britain's trade with the self-governing colonies while her trade with her other colonies stagnated. Imperialism, he concludes, is unprofitable to the economy as a whole.

Considering the popular argument that migration[39] of Britain's excess population to her colonies is a tool of imperialism, Hobson finds Britain under no such pressure, since her population at this time was tapering and nearing a stationary status, and her internal rate of growth of wealth exceeded that of population. Of the emigrants from Britain, less than half went to British territories.

Reaching for an explanation[40] of the "small, bad, unsafe increase of markets" brought about by the colonial acquisitions by Britain between 1850 and 1900, Hobson argues that these were caused by "the economic parasites of imperialism," a small group

[37] To this extent, Hobson does recognize the principle of equal marginal returns commented upon in the previous paragraph.
[38] Cf. *supra.* § 2, Definition of Imperialism. [39] *Imperialism, op. cit.*, Ch. III.
[40] *Ibid.*, Ch. IV.

of vested interests of "certain classes and certain trades," particularly the armaments producers, shipping, career militarists and manufacturers specializing in export products, even though they constitute but a small area of total industry in Britain. But most important of all, financiers and foreign investors are held responsible. External trade of Britain shows profits of £18,000,000 on *trade* of £800,000,000 in 1900, or $2\frac{1}{2}$%. But income to British *investors* from abroad is much larger: £100,000,000 on investments of £2,000,000,000 in 1900, or 5%.[41] The *rate of growth* of such investment income during the last part of the nineteenth century exceeded the *rate of growth* of such trade profits by far.

Modern British foreign policy, Hobson argues, has been primarily to preserve the investments and not the trade. France, Germany and the United States were following the British pattern in this regard but were some years later in starting. In all cases the initial point was the large surpluses accumulating in the hands of the middle classes which could not find profitable outlet at home *under the existing economy*.

Hobson next takes up[42] briefly the development of protection as a tool of imperialism. Considering the United States separately,[43] he finds that America's rapidly rising standard of living absorbed only part of the rapid increase in production after 1870, and left large sums for foreign investment. In this process, trustification played an important part—the first step in establishing a trust is cut-throat competition, dumping more on the market than it can consume except at ruinous prices which eliminate the weakest competitors. Once the trust is established, it must seek foreign outlets for either its excess output (if it is to continue to enjoy the cost advantage of high volume) or its excess earnings, or both. The former means "dumping" and the latter, foreign investment or in the case of the United States at the time when Hobson wrote, the repayment of debt then owed to Britain and home acquisition of previously foreign-owned assets, thus forcing British investors to find new investments.

[41] This is not to imply that rate of profit on sales is directly comparable to rate of profit on investment.
[42] *Ibid.*, Ch. V. [43] *Ibid.*, Ch. VI.

This condition of surplus home funds seeking foreign investment is termed by Hobson the "taproot" of imperialism.

As evidence of the lack of adequate investment outlets, Hobson cites[44]

> "the existence at such times [i.e., prosperity] of large bank stocks of idle money seeking any sort of profitable investment and finding none."

He assumes what is to be proven: that the funds are idle not because of high interest rates but because of a dearth of investment opportunities.

In support of his contention that financiers and foreign investors dominate in imperialism, Hobson cites British figures:[45]

Annual average	Foreign trade	Public expenditures
1870– 75	£636,000,000	£ 63,160,000
1895–1903	868,000,000	155,660,000

Annual average	National income	Military expenditures
1870– 75	£1,200,000,000	£25,000,000
1895–1903	1,750,000,000	79,000,000

The military expenditure increase associated with the foreign trade increase is unprofitable in view of the total profit from foreign trade of £18,000,000 or 2½% on sales in 1900. When viewed against the return on foreign investment of £100,000,000 in 1900 (in addition to profit on trade) the picture is more intelligible. This is particularly true when consideration is given to the fact that a large part of the military expenditures accrue to the owning class of investors via armaments and even more so when consideration is given to the tax burden which does not fall *in toto* on the owning class.

Part of the cost to the financiers of Britain at that time lies in the grants in aid of local taxation in the national budget of £12,000,000 which to Hobson are a subsidy to landowners to enlist their support of imperialism.

[44] *Ibid.*, p. 82. [45] *Ibid.*, pp. 94, 95 and table, p. 379.

But it is on the taxation side that the policy of imperialism comes clearly into view:[46]

> "The object of these economic interests which use the public purse for purposes of private gain is in large measure defeated if they have first to find the money to fill that purpose. To avert the direct incidence of taxation from their own shoulders on to those of other classes or of posterity is a natural policy of self-defense."

Whereas Hobson argues for taxation of surplus as the means of curing the over-saving which imperialism attempts to cure, imperialism has diverted tax policy to its own end and increased the over-saving problem. Hobson begins with the Free Trade policy of the 1840's under Peel, showing the triumph of the commercial group over the landlords. At that time the income tax was reimposed to help finance Free Trade. Continued stress such as the Crimean War made the tax permanent when the only alternative was a return to Protection:[47]

> "The financial attack on 'property', embodied in the progressive income tax and death duties, must be regarded, then, as an exceptional policy, due mainly to two causes—the difficulty of reverting suddenly to the abandoned practice of Protection, and the desire to conciliate the favour of the new, unknown democracy."

Hobson, remarkably, foresees the abandonment of Free Trade policy for two reasons: (1) the effort to increase revenue by indirect taxation to support the growing military expense of imperialism,[48] and (2) the requirement that "a military nation surrounded by hostile empires must have within her boundaries adequate supplies of the sinews of war, efficient recruits, and a large food supply.[49]

The only alternative to abandonment of Free Trade would be "a large radical scheme of land reform."[50] The balance swinging the answer to Protection might well be the bounties needed for the shipbuilding trade. Hobson recalls that British foreign trade in the first instance was founded on the navigation laws. The

[46] *Ibid.*, p. 97. [47] *Ibid.*, p. 100. [48] *Ibid.*, p. 102. [49] *Ibid.*, p. 103. [50] *Ibid.*

precision of Hobson's thought summarizes the prediction: which has been since validated:[51]

> "Protection will not be Protection, but Free Trade within the Empire; a protectionist tariff will hide its exclusive side and masquerade as an Imperial Zollverein."

The role of the public debt alongside expenditures, taxation and protection as tools of imperialism he summarizes:[52]

> "The creation of public debt is a normal and a most imposing feature of imperialism. Like Protection, it also serves a double purpose, not only furnishing a... means of escaping taxation upon income and property otherwise inevitable, but providing a most useful form of investment for idle savings waiting for more profitable employment." [Hobson refers in this connection to tax-free government securities.]

The only legitimate criticism of the evidence and arguments marshalled by Hobson to support his theory of imperialism rests upon the lacunae of his logic already pointed out: the failure to incorporate into his sytem the role of monetary expansion as a creator of demand; his neglect of interest rate adjustments and of deepening of capital; his use of constant coefficients of production, particularly through time; his gratuitous assumption of the existence of surplus in exchanges between parties of equal bargaining power under the market system. These theoretical limitations do not affect affirmatively the validity of the evidence used by Hobson.[53]

8. LATER MODIFICATIONS OF HOBSON'S THEORY OF IMPERIALISM

Perhaps the greatest modification of Hobson's original thought with regard to imperialism occurs during the first decade following the publication of *Imperialism*. Two propositions stand out. First, Hobson comes to feel he overemphasizes the economic

[51] *Ibid.*, p. 105. [52] *Ibid.*, p. 108.
[53] It is beyond the scope of this study to consider the Politics of Imperialism as Hobson develops that argument. It is generally conceded that the political theory of imperialism developed by Hobson is stronger than the economic theory.

determination of history he states in *Imperialism*.[54] Secondly, the vital, evil role he assigns to high finance in *Imperialism* is modified to such an extent[55] as actually to have international finance considered as a possible tool of peace—through the principle that stability and security in the international order are necessary to profitability of foreign investments. But he still considers the danger real that international finance cooperates primarily to exploit labor both at home and abroad.[56]

Hobson's study of finance, starting from the critical role he assigned it in *Imperialism*, leads him to an extensive and detailed presentation in *An Economic Interpretation of Investment*. In this volume, aside from the hopeful attitude towards international finance above noted, Hobson speaks against "Government Loans." He distinguishes "State loans" for "railroads, harbours, land reclamation, water works," etc. which are "permanent and fructifying," from the "Government loan" which he calls "so vague and attenuated that it cannot rank seriously in our account of the 'economic work' of investments. Such loans have in effect been the great despoilers of industry, and, by the temptations they present to certain classes of the saving public, the great retarders of individual development."[57] While Hobson advocates an attack on over-saving via more social service expenditures by government and more direct taxation of surplus, he opposes an unbalanced budget as a tool of eliminating underconsumption.[58]

It is not easy to understand the great shift in tenor between *Imperialism* (with its adaptability to neo-Marxian thought[59]) and *An Economic Interpretation of Investment*[60] with its thoroughgoing defense of foreign investment as economically sound for both the debtor and creditor countries and its advocacy of stable international relations as a pre-requisite for foreign investment.

[54] As he himself points out in *Confessions of an Economic Heretic*, *op. cit.*, p. 63.
[55] In *An Economic Interpretation of Investment* (London: Financial Review of Reviews, 1911), pp. 116f. Among the neo-Marxians, Hilferding's *Finanzkapital* follows the emphasis on finance. This is discussed below, § 11.
[56] In *Rationalisation and Unemployment* (London: Allen, 1930), p. 115.
[57] *An Economic Interpretation of Investment*, *op. cit.*, p. 23.
[58] This is, of course, an important distinction from Keynes' position in his *General Theory of Employment, Interest and Money*, *op. cit.*
[59] See § 11, below.
[60] Although even the later approach to international finance is readily enough adapted to neo-Marxian thought as Hilferding shows. See § 11 below.

The reconciliation, however, is in the compatability with underconsumptionism. For Hobson, *Imperialism's* main importance is its illustration of underconsumptionism. The language of *Imperialism* was probably heightened by Hobson's distaste for the Boer War as he saw it personally.

He summarizes the arguments for a benevolent imperialism in terms of gains to the investing country:[61]

1. Export trade increase is involved in the act of investment, since money can be invested abroad only by sending goods abroad.

2. A stimulus for home industries stems from interest payments coming in the form of goods which lower the costs of home industry, and thus expand home markets and foreign trade at the same time.

3. A share of new wealth in the debtor country is gained by the very process of exchange. All profitable exchange benefits the investing country by more than the amount invested.

4. Special trade advantages follow to the investing country upon giving financial assistance.[62]

9. QUALIFICATION ON FREE TRADE RECOGNIZED IN 1937

Although in his first work in 1889[63] Hobson recognized the qualification on the free trade argument implicit in underconsumption arguments, this appears to have been a forgotten insight until 1922 when he rediscovered this matter.[64]

In 1889 the insight was incidentally stated in this way:

> "we also note that the charge of commercial imbecility, so freely launched by orthodox economists against our American cousins and other Protectionist Communities, can no longer be maintained by any of the Free Trade arguments hitherto adduced, since all these are based on the assumption that over-supply is impossible."

[61] *An Economic Interpretation of Investment, op. cit.*
[62] More detailed discussion of specific illustrations appears infra, p. 53f.
[63] *The Physiology of Industry, op. cit.*, p. ix.
[64] *Economics of Unemployment, op. cit.*, Appendix.

The point is more fully developed in 1937. When "unemployment is rife in most of our chief manufactures it was wrong to admit foreign goods which could be made at home, employing the capital and labour which was standing idle."[65] It is possible for one country to benefit when there is general unemployment throughout the world and to benefit at the expense of other countries. There would be an offsetting factor in domestic demand shrinkage due to higher prices following upon protective tariff. Hobson cites Adam Smith's argument from the standpoint of employment and profit of capital as applicable to employment of labor.[66] The domestic demand shrinkage due to higher prices would require employment of more capital and labor to give the original consumer the income that he requires to effect the exchange at the new higher price. This can be lifting by the bootstraps if considered automatic. He recognizes that even this national advantage will not exist "If the increased price our consumers are obliged to pay for the home-made goods substituted for exports is very large." He does not so state, but he is referring to the relative elasticities of demand for the products, former imports and original domestic products. He concedes that this temporary situation creates difficulty later when the world returns to full employment and he concedes that monopolistic practices are encouraged by such a program.

10. HOBSON'S POLICY RECOMMENDATIONS WITH RESPECT TO IMPERIALISM

Hobson's policy recommendations with respect to imperialism are merely "common-sense" conclusions from the logic and evidence of his theory.

First, he would change the pattern of income distribution through higher wages, large social services by government and direct taxation of surplus, but not by an unbalanced budget. These are intended to eliminate oversaving, the ultimate cause of imperialism.

Second, he would eliminate protection even for purposes of protecting a competitive position in export. He urges that Britain "undertake lines of production and trade in which, though Ger-

[65] *Property and Improperty* (London: Gollancz, 1931), p. 124. [66] *Ibid.*, p. 126.

many could undersell us if she undertook them, she would not compete because her capital and labor would be more profitably absorbed in the lines where her advantages were greater."[67]

Third, he advocates international cooperation (1) to avoid "the continual danger to which higher standards of wages and living are exposed" by securing "minimum standards of wages, hours and other conditions of labor in backward industrial countries"[68] but in relative and not absolute terms, and (2) to achieve distribution of the "world-product... more equally and equitably between labor and the other claimants."[69]

Fourthly, Hobson rejects rationalisation as a policy because of its affinity to trustification, although if the elasticity of demand for the great bulk of goods were great that would be a special case for rationalisation.[70]

Hobson does not deal with financial or monetary reforms—a logical sequence of the omission of this element from his theoretical structure as already noted. To the extent that finance is recognized as the regulator of the economic machine[71] he considers it important only to rechannel its motivation and not to abolish its techniques.[72]

This is as far as Hobson goes with specific recommendations about imperialism. Details of most of these recommendations he reserves for his general treatment of underconsumption, with the exception presently to be dealt with: Protection. He specifically reserves the subjects of labor,[73] taxation[74] and rationalisation.[75]

It is a recognized defect of the Hobsonian system that it is topheavy in analysis and stretched thin in synthesis,[76] to the point

[67] In *Economics of Unemployment* (New York: Macmillan, 1922), p. 97.

[68] Hobson appears to give no consideration to ensuing unemployment problems in the backward countries.

[69] *Economics of Unemployment, op. cit.*, p. 105.

[70] *Rationalisation and Unemployment, op. cit., in toto.*

[71] Hobson uses the metaphor in which the fuel of the engine of imperialism lies in patriotism, adventure, military enterprise, political ambition, philanthropy, etc. but the "governor of the imperial machine" is finance, *Imperialism, op. cit.*, p. 59.

[72] *An Economic Interpretation of Investment, op. cit.*, pp. 116f.

[73] In *Economics of Unemployment, op. cit.*

[74] In *Taxation in the New State* (London: Methuen, 1919).

[75] In *Rationalisation and Unemployment, op. cit.*

[76] E.g., Gottfried Haberler, *Prosperity and Depression* (Lake Success: U.N., 3d ed., 1946), p. 118.

where, for example, analysis is limited to the crisis of the trade cycle with little regard for the other phases.

Regarding protection, Hobson organizes his arguments and evidence against such a policy in the following way. The first fallacy of Protection[77] is to present nations as trading firms and with hostile interests. Such a position is contradictory since competition between home firms is keener than between a home and a foreign firm even for foreign trade and competition between home firms is not criticized. Further, the proposition presents foreign markets as limited so that what one country gains is another's loss.

Secondly, there is the fallacy of arguing that only one, the seller or the buyer, can gain from a transaction.[78] This fallacy arises from a natural tendency to examine the amount of money received more closely than the prices of the goods on which the money is spent. This is furthered once the seller focuses on the money received (1) by separating the sellers into distinct groups so that each group concentrates on its own receipts and (2) by then concentrating on the advantage which accrues to each group if the other home groups fail to adopt Protection.

Hobson then illustrates these propositions by British experience from 1850 to 1900. He brings out especially:

1. the gains to certain groups better organized and politically more articulate,[79]

2. the growth of Protection through war pressure when governments are unwilling to step up direct taxation sufficiently,[80]

3. the one "real" argument for Protection: periods of unemployment and depression,[81]

4. the argument based on glamour, colonialism and national defense,[82] which latter contains a real element *during* war, but continued *after* peace is established, encourages the *next* war,

5. the circular type of selective discrimination developed by the protecting country among the other nations to prevent reactions such as might develop if all countries felt the impact of protection at the same time,

[77] *The New Protectionism* (New York: G. P. Putnam's Sons, 1916), p. 2.
[78] *Ibid.*, p. 5. [79] *Ibid.*, p. 10. [80] *Ibid.*, p. 12.
[81] *Ibid.*, p. 19, but Hobson rejects even this argument in *Economics of Unemployment*, *op. cit.*, p. 105. But *cf. ibid.*, Appendix.
[82] *The New Protectionism*, *op. cit.*, p. 22.

6. the final "refuge" in selecting "key industries" which are to be protected at all costs,[83]

7. the futility of protection as a way to meet trade aggression by foreign countries, e.g., in the case of Germany in chemistry, affirmative development of British chemistry is the ordinary competitive development,[84]

8. the better remedy in the special case of agriculture through a liquidation of the "medieval land tenure" which reduces efficiency,[85]

9. the truth of the argument that British trade depends on British shipping derives not from the early protection of the Navigation Laws, but the commanding position of the British merchant marine really comes through a later policy of free ports and markets,[86]

10. British financial development parallels her shipping.

In *International Trade*,[87] Hobson presents no new[88] theoretical arguments and in the practical area, the evidentiary arguments found in *The New Protectionism*, just set out, do not appear as fully.

In *Towards International Government*,[89] Hobson, strangely enough, does not discuss the proposition that changing the pattern of income distribution is a remedy for imperialism, but confines himself entirely to the mechanics of international government.

11. NOTE ON RELATION OF HOBSON TO MARXIAN THOUGHT ON IMPERIALISM

Karl Marx considered imperialism[90] as a temporary, growing-

[83] *Ibid.*, p. 46. [84] *Ibid.*, Ch. VI. [85] *Ibid.*, Ch. VII. [86] *Ibid.*, Ch. VIII.

[87] London: Methuen, 1904.

[88] As Hobson says, *ibid.*, in the preface: "The book contains no new theory, but it departs in one important particular from the treatment of international trade adopted in Great Britain by most economic writers since Ricardo and J. S. Mill. This departure consists in a simplification of the theory of foreign trade by the extension to it of the same laws as govern the rates of exchange between commodities within a single nation."

[89] New York: Macmillan, 1916.

[90] The matter has been summarized by E. M. Winslow, *The Pattern of Imperialism*, *op. cit.*, p. 137: "Marx said nothing to indicate that the seeds of imperialism might reside in this process [of unbalanced income distribution]. Here, as well as in his failure to regard exports as an offset to underconsump-

pains stage of capitalism and not vital in his theory of the crisis as it is in Hobson's writings. The difference follows logically from the basically different views of the two men with regard to surplus. For Marx, surplus value is the exclusive product of labor; for Hobson it arises from various hindrances to perfect equality of bargaining power and the inherent vice of the market as a system of distribution. Accordingly, Marx predicted the collapse of capitalism; Hobson, its reform.

Neo-Marxians, however, developed the subject of imperialism, some[91] finding imperialism an integral consequence of the Marxian logic and others[92] holding to a more literal interpretation of Marx and arguing that imperialism is not to be expected to continue as capitalism advances. It remained for Lenin and Rosa Luxemburg to make imperialism an integral and official part of Marxian thought.[93] Lenin accepts Hobsonian imperialism *in toto* though it be that of a "frankly pacifist and reformist Englishman, Hobson."[94] Lenin accepts both the political and economic analyses of imperialism by Hobson.[95] In particular, Lenin follows the Hobsonian vision that the great powers may federate and this

tion and in his silence regarding the crucial element of capital export, Marx left no basis for a theory of imperialism. The nearest he came to providing such a basis was in that part of his analysis in which he visualized imports as an offset to the declining rate of profit. This provided a weak basis at best." While Marx pointed out that early capital exports of the sixteenth century's imperialism became the capital for the Industrial Revolution, he did view imperialism as a growing-pains stage of capitalism.

[91] E.g., Rudolf Hilferding, *Das Finanzkapital* (Vienna: Brand, 1910). Hilferding, however, abandoned the Marxian thesis that capital is its own undoing and argued that capitalism would stabilize under trustification. He agreed strongly with the Hobsonian view that finance was the governor of imperialism.

[92] E.g., Karl Kautsky, "Der Imperialismus," *Die Neue Zeit*, vol. 32, pp. 908–22 (1914).

[93] V. I. Lenin, *Imperialism, the Highest Stage of Capitalism* (New York: International Publishers, 1933) originally published in Russian in 1916.

[94] *Ibid.*, p. 12f. As Paul M. Sweezy, *The Theory of Capitalistic Development* (New York: Oxford, 1942) argues at p. 307: "Lenin's book on imperialism, it should be remembered, was brief and much of it was devoted to summarizing supporting facts and figures."

[95] *Ibid.*, pp. 83, 92, 94. Similarly Rosa Luxemburg accepts the economics of the Hobsonian imperialistic theory *in toto. Die Akkumulation des Kapitals, Ein Beitrag zur ökonomischen Erklärung des Imperialismus* (Berlin: Verlags-Anstalten, 1922). English translation A. Schwarzschild, *The Accumulation of Capital* (New Haven: Yale University Press, 1951). She superimposes ideological arguments.

would emphasize the evils of imperialism.[96] Lenin follows Hobson in arguing:[97]

> "Imperialism is the monopoly stage of capitalism, or capitalism in that stage of development in which the domination of monopolies and finance capital has taken shape: in which the export of capital has acquired pronounced importance; in which the division of the world by the international trusts has begun, and in which the partition of all the territory of the earth by the greatest capitalist countries has been completed."

Aside from the conclusions as to the culmination of the imperialist process, the only difference between Hobson and Lenin is in the role of war in imperialism: Hobson denies imperialism as even a primary, much less a sole cause of war; Lenin is to the contrary.

12. NOTE ON RELATION OF HOBSON TO SCHUMPETER'S THOUGHT ON IMPERIALISM

In essence, Schumpeter argues[98] that the power complex overrides economic and rational behavior generally and that imperialism, a non-economic or power force, atavistically survives in a capitalistic or economically rational era. Schumpeter agrees with the original position of Marx that imperialism antedates capitalism. To Marx its survival is atavistic—imperialism being a growing-pains stage of capitalism.

Although Hobson argues for an economic or rational imperialism, over half of his volume[99] is devoted to the politics of imperialism and he recognizes the power complex in such words as:[100]

[96] *Ibid.*, pp. 87, 106.
[97] *Ibid.*, pp. 80f.
[98] Joseph A. Schumpeter, *Imperialism and Social Classes* trans. by H. Norden (New York: Kelley, 1951), being a reprint of two essays. The first, on imperialism, originally appeared as "Zur Soziologie der Imperialismus," *Archiv für Sozialwissenschaft und Sozialpolitik*, vol. XLVI, Dec., 1918, pp. 1–39 and June, 1919, pp. 275–310. E. M. Winslow, *The Pattern of Imperialism, op. cit.*, contains a section on Schumpeter, pp. 229–237: "Imperialism as an Atavism."
[99] *Imperialism, op. cit.*, pp. 113–386.
[100] *Ibid.*, pp. 224f.

> "The animal lust of struggle, once a necessity, survives in the blood, and just in proportion as a nation or a class has a margin of energy and leisure from the activities of peaceful industry, it craves satisfaction through "sport", in which hunting and physical satisfaction of striking a blow are vital ingredients."

To Schumpeter, capitalism was burdened with imperialism and militarism as survivals of an earlier age;[101] to Hobson they were not burdens to capitalism but natural parts of its workings—as underconsumptionism would indicate.

Schumpeter argues that in the Middle Ages the military class reached its peak and sought moral defense for its activities.[102] The growth of commerce, banking, the industrial system and the division of labor created a situation where excess energy was devoted to acquisition rather than destruction. The business world drew talent from the military. War became a nuisance and not a normal routine. The bourgeois class succeeded the military class and pervaded every activity in the same way as its predecessor had. Individualism and rationalism replaced authoritarianism and rivalry. Imperialism is thus atavistic,[103] but a restless survivor of the previous age.[104]

In later revision of his thinking[105] Schumpeter changes his original position that community of interest among nations will overcome cartels and monopolies and that only industrialists and financiers gain by war. He indicates[106] that Renner's[107] view of

[101] Schumpeter, *Imperialism and Social Classes. op. cit.*, p. 1: "A concrete interest need not be economic in character—the interest need not necessarily extend to the *entire* population of the state—"; p. 6: "what needs to be explained is how the will to victory came into being..."; p. 7: "now it may be possible, in the final analysis, to give an 'economic explanation' for this phenomenon, to end up with economic factors..."; but p. 90: "a purely capitalist world therefore can offer no fertile soil to imperialist impulses." People are too busy pursuing economic ends rationally to engage in destruction and fight for fight's sake.

[102] *Ibid.*, Ch. III. Schumpeter goes back to ancient times (Egyptian, Assyrian and Persian Empires). [103] *Ibid.*, p. 84.

[104] *Ibid.*, p. 14: "All other appeals are rooted in interests that must be grasped by reason. This one alone [imperialism] arouses the dark powers of the subconscious, calls into play instincts that carry over from the life habits of the dim past."

[105] Primarily in *Business Cycles*, 2 vols. (New York: McGraw, 1939).

[106] *Ibid.*, vol. II, p. 696n.

[107] Karl Renner, *Marxismus, Krieg und Internationale* (Stuttgart: Dietz, 1918).

"social imperialism" is closer to the truth than either the Marxian or his own view of atavistic survival. Renner's position is that classes entirely unconnected with the old traditions replace the older classes but with the same motives: motives that are non-rational from the economic viewpoint and follow from non-economic ends, the will to fight and conquer, a *Volks-imperialismus*. This position is perfected by Scilliére.[108]

To support his thesis, Schumpeter argues that in England the business man replaced the military while in Germany the two classes continued side by side.[109] Hence there is in Germany a stronger survival of monopoly, protection and imperialism, all being forces in existence prior to capitalism.

Schumpeter concludes with:[110]

> "Export monopolism does not grow from the inherent laws of capitalist development... On the contrary, any plant runs up against limits to its growth in a given location; and the growth of combinations which would make sense under a system of free trade encounters limits of organizational efficiency."

and earlier:[111]

> "Even with free trade there would be capital exports to the countries offering the highest interest rate at any given time."

Marxists argue against this that the triumph of free trade in England in the nineteenth century was a natural and logical capitalist development because England was the first industrialized nation and free trade policy would more effectively protect the country with such an advantage than any protection policy—so long as England enjoyed industrial supremacy, which was down to the first World War.[112]

[108] Ernest Scilliére, *La philosophie de l'impérialisme*, 4 vols. (Paris: Plon-Nourrit, 1903–08).

[109] *Imperialism and Social Classes*, *op. cit.*, Chs. 2, 5.

[110] *Ibid.*, p. 117.

[111] *Ibid.*, p. 110n. As further example he cites (p. 95) the United States as the nation with the least pre-capitalist elements—and also the least imperialism at the very time when imperialism would have been economically most easy to justify for the United States.

[112] *Ibid.*, p. 8. Schumpeter had respect for the Marxian analysis: "Beyond doubt

Marxist interpretation finds it easy to fit fascist development into this pattern as an intensifying of the class struggle between nations. Schumpeter on the other hand fits fascism in as the reaction of one nation to the imperialism of another nation. As the military force grows in one nation, it must grow in other nations for fear of the consequences if it does not grow.[113]

SUMMARY

To summarize briefly, Hobson is first in the field in modern times with his *Imperialism* in 1902. Prior to that Marx viewed imperialism as a growing-pains stage of capitalism. Hobson views imperialism as a special case of underconsumption and as such an integral part of capitalism and capitalistic growth.

Lenin is next in the field in 1916 with a frankly complete adoption of the mechanics of Hobson's economic imperialism but with a different view of the role it will play in the future of capitalism. While Hobson foresees the peaceful, if fitful, resolution of underconsumptionism through wage, tax and expenditure reform, Lenin sees imperialism as part of the process of class struggle leading to the destruction of capitalism.

Hilferding in 1910 and Bauer in 1913 as well as Luxemburg in 1922 similarly find imperialism an integral part of Marxian economics but Kautsky in 1914 denies such a relationship, arguing that imperialism is an older phenomenon and capitalism a more recent development and hence there is no logical connection.

Schumpeter comes on the scene in 1918–19, apparently ignorant at that time of both Lenin and Hobson, but not of his fellow students Bauer and Hilferding. He takes a third position: imperialism as an atavistic survival logically at war with the economics of capitalism—an irrational survival, which may in time give way to the more dominant free trade and rationalism but meanwhile continues to be a restless counter-force.

this [neo-Marxian imperialist analysis] is by the far the most serious contribution towards a solution of our problem [imperialism]."

[113] Schumpeter's rejection of Marxist imperialism is found in his *Business Cycles*, *op. cit.*, I, p. 432; II, p. 696.

CHAPTER V

THE CONCEPT OF SURPLUS — THE KEY TO HOBSONIAN ANALYSIS?

1. GENERAL STATEMENT

Although present in the theory of imperialism in only embryonic form, the concept of "surplus" is the starting point of Hobsonian analysis in the theories of imperialism, underconsumption and taxation. Wedded to the concept of surplus is inequality of income distribution. To what extent are either or both of these elements essential to the Hobsonian analysis? Inequality is reserved for Chapter VI.

In a nutshell, Hobson finds the source of economic trouble in the improved production techniques giving rise to an increased output which is not distributed according to the "cost requirement" of the factors of production. That portion not so distributed accumulates in the hands of the holders of "surplus" who can only invest it in methods which will increase the flow of goods or further decrease the employment of labor. And with decreased employment of labor comes decreased capacity of the economy to consume. This situation can only be corrected either by labor receiving the increased output through higher wages or lower prices, or by taxation and public expenditures equalizing the distribution of income with the same result.[1] Of the two, Hobson believes the taxation-expenditure approach more feasible. A special case for at least temporary relief from over-saving arises where more advanced countries develop backward areas of the world.

The advance of this statement over that presented in *The Physiology of Industry*[2] lies in the development of the causes of

[1] *Rationalisation and Unemployment* (London: Allen, 1930), Ch. vi.
[2] *Supra*, Ch. III.

oversaving—whereas *The Physiology* deals primarily with the consequences of over-saving.

2. HOBSONIAN PROFITS AND SURPLUS

In the Hobsonian system, profits are:[3]

> "attributed to the skill, judgment and enterprise of *entrepreneurs* and investors, or to control of markets by monopoly or other forms of bargaining, or to the possession of superior natural resources, or to hazard—profits do not appear to be necessary costs of production, but rank as surplus after capital, labor and ability are paid their subsistence wage."

The concept of profits (and here he seems to blend all "surplus" into "profits") is further defined:[4]

> "In a word, profits do not bear the same relation to capital as wages to labor in a business. For, before profits come into being, a provision for capital out of gross earnings has been made equivalent to the subsistence wage paid to labor.This payment for maintenance of capital does not figure in the net income of business—The importance of this consideration arises from the fact that it invalidates a claim commonly maintained, that in any business the claim of capital to its normal interest or profit stands on the same economic level of necessity as the claim of labour to its subsistence wage."

This presentation conflicts with that in Hobson's theory of taxation.[5] There, part of the return to capital is recognized as a "cost" and only part as "surplus". The "cost" is not restricted to depreciation or even the money risk of replacement but includes enough to recompense by way of necessary incentive the foregoing of other uses of income.

Similarly, the view in his theory of taxation does not jibe with the earlier view he held: "We cannot with advantage treat pro-

[3] *Rationalisation and Unemployment, op. cit.*, p. 15.
[4] *Ibid.*, p. 19.
[5] *Taxation in the New State* (New York: Harcourt, Brace, 1920), p. 18, with reference to part of interest as a "cost"; p. 23, with reference to part of profits as a "cost" and similarly for that part of rent constituting recovery of improvements on land.

fits as we do rent, wages and interest as payment for so much quantity of productive energy utilized in the industrial process."[6] At that time he gave a page of definitions[7] including:

> "1. *Costs* are that part of the product, or its equivalent in other goods, necessary as payments to maintain the current output of productive energy in a factor of production.
> 2. *Surplus* is that part of the product which remains after costs are defrayed. It is divisible into productive and unproductive surplus.
> 3. *Productive surplus* consists of such payments to owners of factors of production in excess of cost as are necessary to evoke such increase of industrial structure or power as can, by cooperation with a proportionate growth of other factors, yield an increased quantity or improved quality of product.
> 4. *Unproductive surplus* consists of such payments (in the form of rent, excessive interest, profit or salary) to owners of factors of production as evokes no such increase of product."

A more lucid statement of the concept of surplus is presented in 1925 when Hobson argues that a basic defect of neo-classical economics and marginalism lies in applying the utility concept exclusively on the demand side and ignoring the concept of disutility on the supply side.[8] As a result no unearned surplus can arise in such a system, since all factors are then paid what they are worth and their pay exhausts the total product. Unfair bargaining power forces the incorrect translation of utilities and disutilities into money terms that do not reflect the true situation. Any separation of "economic" from "non-economic" satisfaction is erroneous since all satisfaction is of one kind. While Hobson does, upon occasion, rest his surplus on this basis, he just as often defines it (as he did finally) *within* the framework of neo-classical economics as producers' surplus, while denying consumers' surplus.

The final statement of the "surplus" concept is found in

[6] *The Industrial System* (New York: Longmans, 1909), p. 58.
[7] *Ibid.*, at p. xi.
[8] "Neo-classical Economics in Britain," *Political Science Quarterly*, vol. 40, pp. 337–383 (1925) at pp. 351–53. This statement is not true of Jevons nor of the later Keynes.

Hobson's autobiography[9] where he starts with the Ricardian statement of rent theory, that is to say, differences from a no-rent margin. He finds this defective as soon as it is realized that the same land has several alternative uses, and even the lowest use of the land can pay a rent based on scarcity and the alternative cost of substituting other factors more intensively. Then he follows with this formulation:[10]

> "This reflection made it obvious that 'land' did not differ from capital and labour as regards price and productivity. There existed in any productive community capital, in the sense of plant, raw materials, etc. which was inferior to other capital, and was only just worth using at any particular time if its service could be purchased at a nominal price, just covering cost of maintenance or of replacement—the more efficient plant and labour got payments corresponding to their superiority over the 'marginal' plant and labor—Payments out of the price of the ultimate products thus emerged under several heads, applicable to each of the factors: first, costs of maintenance or replacement, applicable to land as to capital and labour; secondly, marginal or minimum payments to the owners of the least efficient of the several factors in employment; finally, differential payments due to the owners of super-marginal factors."[11]

So far, Hobson says, the analysis justifies in necessity and in equity the current economic system.

> "But further reflection showed me that two false assumptions underlay this view, one that all units of production were infinitely divisible in quantity, and secondly, that they enjoyed equal opportunities for entering any market for their employment."[12]

[9] *Confessions of an Economic Heretic* (London: Allen, 1938), p. 45.
[10] *Ibid.*, p. 47.
[11] This thinking Hobson first set forth in "Law of the Three Rents," *Quarterly Journal of Economics*, vol. 5, pp. 263–88 (1891), classifying factor return as three elements: 1) differential over next best factor of same kind, 2) advantage of using factor in its present use compared to next best alternative use, and 3) yield from next best alternative use. This became his theory of surplus value in chap. x of *Economics of Distribution*, (New York: Macmillan, 1900).
[12] *Confessions of an Economic Heretic*, *op. cit.*, p. 47.

This, Hobson says:[13]

> "led me in the late nineties[14] into my early challenge of the equity of the distribution of incomes. I then set myself to examine the actual operations of the owners of supply and demand, as expressed in the bargaining that determined those market prices which are the main instruments for the distribution of incomes. From this examination there emerged two salient truths: first, that in many markets the volume of supply was restricted, naturally or artifically, so as to give sellers, as a body, a superior bargaining force for the sale of their goods, reflected in a higher price than was economically necessary to evoke their productive services. Secondly, the selling prices, even where 'free bargaining' prevailed, were determined in accord with the relative importance to certain buyers or sellers of effecting a purchase or sale: these marginal buyers or sellers fixed the price at a point where it was just worth their while to buy or sell, the other buyers or sellers got from this price something more than would have been a sufficient inducement, i.e., a "surplus" element. This "surplus" corresponding to differential rent for land, had no rational or equitable basis: it was an element of 'unreason' permeating the bargaining process in all markets, either for consumption goods, production goods, or productive services."[15]

It is submitted that there is a steady growth in thinking here with reference to the term "surplus" which is more a process of clarification than of inconsistency. In the 1909 statement (*The Industrial System*) there is merely the general notion that there is surplus in any factor to the extent there is payment in excess of what is needed to draw it forth into production.[16] In the 1920

[13] *Ibid.*, p. 19.
[14] *The Economics of Distribution* (New York: Macmillan, 1900).
[15] *Confessions of an Economic Heretic*, *op. cit.*, p. 19. This discovery "whether under monopoly or so-called competitive conditions markets are intrinsically unfair modes of distribution" (*Confessions*, p. 168), Hobson considers "my most important heresy, and therefore the one for which I have least succeeded in gaining attention, even in the form of hostile criticism, from the orthodox economists."
[16] In *The Problem of the Unemployed* (London: Methuen, 1896) at p. x Hobson refers to surplus as "economic rent and superfluous elements of profits."

statement (*Taxation in the New State*) there is a recognition that a part of "surplus" must be reckoned a "cost" in order to insure progress and growth, this element being brought into focus by the matter of incentive taxation. In the 1930 statement (*Rationalisation and Unemployment*) there is a reluctance to go as far as in 1920 in that the concept of "surplus" has now come far enough to be recognized as Marshallian producers' surplus[17] and there is the realization that each factor owner has a different reservation price. Finally in 1938 (*Confessions of an Economic Heretic*) the concept has grown to the full realization that a competitive price system necessarily involves such a situation to the point where policy for purposes of taxation and justice in distribution cannot be as neatly handled as had been hoped earlier. Inability to put the concept on an operational basis disturbed Hobson and gradually he dropped his emphasis on the concept until in the 1920's it plays only a passing part in his works.

3. EVALUATION OF THE SURPLUS CONCEPT

In his autobiography, Hobson in connection with the surplus concept refers to "the question how far the pleasures and pains of one man can be compared with those of another."[18] Likewise, he questions the differentiation of "the satisfaction and dissatisfaction one calls 'economic' from other vital goods and ills which lie outside this economic ambit." Even so he doubts "how far one can take as criteria of human value the actual satisfactions and dissatisfactions currently attributed to various acts of production and consumption—[without]—insisting upon reference to what Ruskin termed their 'intrinsic values'." He concedes[19] "I cannot profess complete success in my attempt [in *Work and Wealth*] to put these different sources of income on a single consistent footing."

Thus Hobson is raising questions at the end over and above

[17] Hobson denies any consumers' surplus, however. This denial, supports an important proposition of tax incidence to be discussed later. While producers' surplus is measured and consumers' surplus is not, this is no reason for denying the latter, as first pointed out to Hobson by J. L. Laughlin in "Hobson's Theory of Distribution," *Journal of Political Economy*, vol. 12, pp. 305–326 (1904).

[18] *Confessions of an Economic Heretic*, *op. cit.*, p. 42.

[19] *Ibid.*, p. 165.

the difficulties with the "Surplus" concept for operational purposes. That he is basically dealing with the Marshallian concept of producers' surplus is not frequently acknowledged by Hobson although one can find references to Marshall's *Principles*[20] in Hobson's works, but most of these (except in *Economics of Distribution*) are to historical information and opinions of England's industrial development.

While Hobson uses the surplus concept in his theories of taxation and underconsumption, it does not appear to be essential. Only to the extent that the system of markets is ill-adapted to minimizing human costs (to society as a whole) and maximizing utilities (to society as a whole) is this surplus required in his theory of the cycle. Other than this, Hobson is concerned with the surplus as a *datum* from which originates underconsumption or oversaving, remembering that for him the two are identical. It must be admitted that "surplus" emphasizes or intensifies the problem of the cycle, and it cannot be avoided as a question when evaluating the solution of the cycle by equalizing income distribution through higher wages (or lower prices) or higher taxes on larger incomes. But Hobson's main concern with the concept of surplus apparently is to establish an ethical argument to parallel his economic analysis of underconsumption.

From an operational viewpoint, the most workable statement of the surplus concept is the breaking up of factor price into three elements: replacement, the minimum payment to the marginal producer (including both alternative use payment and forced gain payment arising from unequal bargaining power[21]) and differential payments to the super-marginal producer. The forced gain is the Hobsonian surplus. Hobson sees that it is the market for the product that draws forth production but does not appear to grasp that the value of capital once committed to production is determined by the market demand for the product *and* the existing state of technology with the alternative uses for that capital.

[20] E.g., in *Evolution of Modern Capitalism* (London: Scott, 1906 ed.) at pp. 27, 49, 120, 327, 343, 345, 350 and 351, and in *Economics of Distribution* (New York: Macmillan, 1900), but not in his other works. Hobson did dispute Marshall's concept of capital (*ibid.*, at pp. 26f): "abstractly, money or the control of money, sometimes called credit, is Capital. Concretely, capital consists of all forms of marketable matter which embody labour. Land or nature is excluded except for improvements: human powers are excluded as not being matter."

[21] *The Economics of Distribution*, *op. cit.*, p. 309f.

At least this interaction is not formally dealt with. In short, he does not appear to realize that his three-fold breakdown is a first approximation, nor that every producer is marginal with respect to his last unit.

4. NOTE ON RELATION OF HOBSON'S THEORY OF SURPLUS VALUE TO THE MARXIAN THEORY OF SURPLUS VALUE

The relationship between Hobson's theory of surplus value and the Marxian theory of surplus value is most effectively and succinctly set forth by Hobson himself:[22]

> "Karl Marx was right in his insistence upon the fundamental importance of recognizing the idea of surplus value. He was wrong in regarding the surplus-value as exclusively the product of labour-power taken by capital in the process of bargaining for the sale of labour-power. He failed to explain why labour, alone of the factors, should be conceived as making all the "value" of material marketable goods. He failed also to explain what the nature of the power was by which capital took the surplus value made by labour; and, finally, he failed to show how any individual capitalist who took it was not compelled to relinquish it under the stress of competition with his fellow-capitalists.
>
> The surplus value here described issues, not merely from one class of bargains (between capital and labor), but from every class; it represents the economic might of the stronger in every market. The true economic motive of the organization alike of labour and of capital is to establish such a power of bargain at some point or other in the field of industry as to obtain some of this surplus."

The disparity is not as great, however, as Hobson claims. Marx likewise lays heavy emphasis upon the matter of relative bargaining power between capital and labor. In addition, while Hobson in theory recognizes that inequality of bargaining power arises in every market, on the operations level he practically confines himself to the inequality of capital and labor.

[22] *Ibid.*, p. 353f.

CHAPTER VI

CRITIQUE OF HOBSON'S THEORY OF UNDERCONSUMPTION

1. THE CHRONOLOGY OF HOBSONIAN UNDERCONSUMPTION THEORY

A brief recapitulation of the chronology of Hobson's underconsumption theory is in order at this point.

His first work, with Mummery in 1889,[1] was considered in Chapter III. Here Hobson places his emphasis on the consequences for the cycle of saving being a function of income rather than of the interest rate and of individuals having a propensity to save in excess of the aggregate requirements of society to maintain the consumption volume that people are willing to purchase. There is no discussion of income maldistribution as the cause of excessive saving; the cause is found rather in the undue propensity to save inherent in all individuals, relative to the requirements of society for capital investment.

From 1896 on,[2] we find a growing emphasis on maldistribution of income as the causal factor responsible for excessive saving. This is combined with the argument that saving is a function of income and not of the interest rate. At the same time, a definite position is taken on the subject of money and credit. These are denied significance as primary causes of cyclical variations, while recognized as factors deepening or heightening the valleys and peaks of the cycle. In particular, the stickiness of the rate of interest is made the focal point of an argument that monetary controls are ineffective. Changes in cash balances, or what

[1] *The Physiology of Industry* (London: Murray, 1889)

[2] Beginning with *The Problem of the Unemployed* (London: Methuen, 1896), p. 88. References to 6th ed.

is later known as liquidity preference, are denied causal significance.

From 1900 on,[3] maldistribution is traced to the existence of "surplus" as the result of the superior bargaining position of sellers in a system of competitive "free markets". The single exception to this rule of seller's advantages is the workman, the seller of labor.

From 1903 (after the writing of *Imperialism*) there follows a quasi-orthodox period until 1919; the underconsumption argument is stated only in *The Industrial System* in 1909[4] and then only in two chapters and without further development except some brief statements about the process of readjustment through downward recapitalization after the crisis. During this period, particularly in *Gold, Prices and Wages*,[5] Hobson works within the orthodox, neo-classical framework of price effects rather than output and employment analysis.

Then in 1919, with *Taxation in the New State*,[6] the remedy for maldistribution through taxation and welfare expenditure is developed and in 1922 the possibilities of wage policy[7] and in 1930 of rationalisation[8] as remedies for underconsumption are considered.

2. HOBSONIAN UNDERCONSUMPTION A GENERAL STATEMENT

Hobson never crystallized his general theory of underconsumption in a single exposition. His position must be pieced together from a number of different writings, the most important of which are:

The Physiology of Industry
The Problem of the Unemployed, especially Chs.v and vi.
The Economics of Distribution
Imperialism, especially the Preface to the 1938 edition.
The Industrial System, especially Chs. iii and xviii.

[3] Beginning with *The Economics of Distribution* (New York: Macmillan, 1900).
[4] *The Industrial System* (New York: Longmans, 1909), Chs. iii and xviii.
[5] London: Methuen, 1913. [6] London: Methuen, 1919.
[7] *Economics of Unemployment* (New York: Macmillan, 1922).
[8] *Rationalisation and Unemployment* (London: Allen, 1930).

Taxation in the New State
The Economics of Unemployment
Rationalisation and Unemployment

The reason for the absence of a single presentation is the overriding concern of Hobson with policy. Theory and policy are more closely commingled in Hobson than in most writers. So far as possible, they are separated in this and succeeding chapters. In this chapter, the skeleton of Hobsonian theory is assembled and criticized, but part of the critique must be reserved for the following chapters on policy.

In one of the last of his fifty-three books, Hobson begins his statement of underconsumption theory, strangely enough, with a restatement of Say's Law:[9]

> "Since all money-incomes are payments to the owners of factors of production for the services of these productive factors, it appears evident that the adequate power to purchase all goods and services is created simultaneously with their production. Throughout all processes of production there is distributed the money that can buy what is produced... Since this money-income *can only* be utilized to purchase products either consumables or capital goods, why should there arise any such failure of markets to keep pace with the expansion of production as actually takes place? *In modern industrial society there is no wish to keep more money idle, in men's pockets or in their bank accounts, than is required for the normal conveniences of economic life.* It might, therefore, be assumed that all incomes when received would without much delay be employed either in buying consumables (spending) or in buying capital goods (*saving*). From the *immediate* standpoint of employment and economic activity, it would seem to make no difference how much of this expenditure went to buying consumables or to buying capital goods." [Italics mine—E.E.N.]

Hobson does not recognize hoarding as requiring any qualification of Say's law.[10] The *fundamental* objection he has is unequal

[9] *Rationalisation and Unemployment* (London: Allen, 1930), p. 33.
[10] Cf. Oskar Lange, "The Rate of Interest and the Optimum Propensity to Consume," *Economica*, N.S., vol. 5 (Feb. 1938) pp. 12–32.

income distribution and the resultant disruption of *the* saving-spending ratio. However, even under an equalitarian distribution, disruption of this ratio might occur from other sources, as Hobson argued in *The Physiology of Industry.* Thus *the* saving-spending ratio is not constant over time unless all other factors in the economy are constant. Self-equilibrating forces handle other sources of disruption adequately, but only depression readjusts deviations from this ratio, which, Hobson argues, usually result from income maldistribution. The interest rate is too slow for the classical method of adjustment to function.[11] Saving, except after the crisis, is considered as always equal to investment—not only in an *ex post* relationship, but as is apparent elsewhere in Hobson, in a planned or anticipated sense as well.[12] This follows from his refusal to recognize any causal role for hoarding.

Say's law makes no assumptions with respect to income distribution.[13] Hence Hobson, whose central argument revolves around *the* saving-spending ratio and its disruption by income maldistribution, cannot be said to accept Say's law. To put it more directly, Hobson accepts Say's law only if the spending-saving ratio is in equilibrium. Hobson's concept of equilibrium, though he makes little use of the term itself, is a situation in which self-equilibrating forces of the classical variety operate with only frictional unemployment of the factors. While Hobson does not

[11] *Rationalisation and Unemployment, op. cit.*, p. 47, *The Problem of the Unemployed* (London: Methuen, 1896), p. 82, *Economics of Unemployment, op. cit.*, pp. 51–57, esp. p. 53.

[12] There is an overgenerous comment by G. D. H. Cole in "John A. Hobson, 1858–1940," *Economic Journal*, vol. 50, pp. 351–60 (1940) at p. 358 where he observes "He did not, at any rate until his latest writings, see clearly the difference between attempted private savings and actual net investment; and his failure to make the distinction plain exposed him to criticisms which only appeared to strike at the roots of his theory. *It is his merit to have challenged effectively the théorie des debouchés which had so long dominated economic thought*, and made it seem impossible that there could arise a real disequilibrium between costs and the income available for the purchase of the current output of industry." Hobson claims to see a *real*, i.e., maldistribution of income, qualification to Say's law, but not the monetary element. *Rationalisation* was Hobson's last major work in economics, and if, as Cole claims above, the matter of attempted savings was seen clearly by Hobson, it must be added that he did not bring out the significance of his belated insight.

[13] To obviate unnecessary duplication of references, the supporting documentation for the present section of this chapter is kept to a minimum. The references are set forth in the succeeding sections where the present general statement is considered in detail.

recognize secular stagnation, he distinguishes between frictional unemployment and depression.

As Haberler correctly points out,[14] the best of underconsumptionist thinking really argues a variety of the oversaving argument.[15] It seems clear that Hobson does not pursue his "underconsumptionism" to its logical conclusion as an over-savings argument because he so strongly feels that he has given an adequate explanation of the crisis in maldistribution of incomes and an adequate remedy in his tax policy. For him, ample explanation of the crisis calls for no detailed explanation of the remainder of the problem of the cycle.

Hobson argues: "...there must be a definite quantitative relation between the rate of production and the rate of consumption, or in other words, between the quantity of employment of capital and labor and the quantity of commodities withdrawn from the productive stream within any given time."[16] He does not indicate any qualification with regard to the role of inventories except in *The Physiology of Industry*. This can be viewed as a rough counterpart in *real* terms of Hobson's unwillingness to recognize *hoarding* in money terms.

Hobson recognized that the equilibrium relation between rate of production and rate of consumption will change through time as tastes, population and production techniques change and these will be self-equilibrating forces. Not included within "tastes" for purposes of this proposition is the consumer's desired allocation between present and future consumption (i.e., saving) unless the consumer is willing to accept the "forced" leisure or increased future consumption which his allocation may demand. Here Hobson finds the major economic dilemma. He completely ignores any concept of the deepening of capital, using a simplified production function.[17]

[14] Gottfried Haberler, *Prosperity and Depression* (Lake Success: United Nations, 3d ed., 1946) at p. 122.

[15] Cf. Note on Relation of Hobsonian Underconsumption to Orthodox, etc. at end of this chapter.

[16] *The Industrial System* (New York: Longmans, 1909), p. 41. There is a kinship to Evsey Domar's argument that $dY = I\sigma$, with σ being constant over time. Cf. Domar's, "Expansion and Employment," *American Economic Review*, vol. 37, pp. 34–55 (Mar., 1947) where he is generous in giving credit to Hobson.

[17] "The right amount of saving out of a given income, i.e., the right propor-

Thus depression arises from the undue weighting of the spending-saving ratio in favor of saving. It will last until the temporary weighting of the spending-saving balance shifts in favor of spending, and this with the obsolescence of much of the unemployed plant has taken out of the system the superfluous capital created in "good times" and the under-production has gone so far as to show indications of short supplies, rising prices, and a trade revival.[18]

3. THE AFFIRMATIVE ELEMENTS IN HOBSONIAN UNDERCONSUMPTION THEORY

After this brief presentation of the Hobsonian argument, we proceed to consider separately the "affirmative" elements of his system—those variables which Hobson ranks as important and the processes by which mutual adjustment between them occurs. Then follows consideration of those variables "neglected" by Hobson and his reasoning supporting their exclusion from the analysis of cyclical processes.

Starting with the key proposition of a unique and relatively constant rate of saving (saving and investment being considered equal, at least during pre-crisis periods) associated with a given rate of spending (consumption), Hobson departs from the usual concept of "saving". Following his emphasis on "real" terms, he objects to restricting "savings" to "material resources" and would include, for example, improvements to "labour-power.'[19] He speaks of two types of saving: social and private, the latter being understood to cover what is usually defined as saving. Fundamentally, "the capitalist system... is in its normal structure ill-adapted for maintaining a right adjustment between the two sorts of saving."[20] Too much of increased productivity accrues to capital and too little to labor. As a result of this, labor's improvement does not keep pace with capital's improvement, adding to the unbalance[21] which unequal distribution

tion of saving, will be determined by the amount of new capital needed to furnish a given increase of consumption goods." *Ibid.*, p. 54.

[18] *The Economics of Unemployment*, *op. cit.*, p. 64.

[19] *Rationalisation and Unemployment*, *op. cit.*, pp. 27, 58. [20] *Ibid.*, p. 29.

[21] *Ibid.*, p. 31.

would cause between saving and spending even in the absence of capitalist organization.

Hobson does recognize the usual assumptions involved in his statement that there is a unique rate of production which is economically in balance with any given rate of consumption.[22]

> "If...society were in an absolutely stationary condition, with a fixed population, fixed wants and fixed methods of industry, the incomes for each year consist in the quantity of commodities (goods and services) produced for consumption... In our fixed or static society all productive energy, after provision for wear and tear fund, would be represented by consumption goods and services... If we are dealing with a community fixed in its numbers and its modes[23] ...The whole of the money-income paid as rent, profits, wages, etc. to members of the society would be spent in demanding commodities for personal consumption."

Starting with this static state, Hobson then removes some of the assumptions to create a static system which introduces savings and investment:[24]

> "...A person who, instead of spending, saves, invests his savings. Now there are two ways in which he may invest his savings. He may hand over the money to someone who wishes to spend it on commodities... Neither 'hoarding' nor this sort of saving makes provision for expansion of production and of consumption in a progressive community. But

[22] *The Industrial System*, *op. cit.*, p. 42, 47.

[23] This must be taken to refer to modes of consumption *and* of production.

[24] *Ibid.*, pp. 51–53. The assumptions removed are: "...The structure and working of the actual industrial system must take account of growth of population, a rising standard of consumption and improved economies in the arts of production... Now in the modern industrial world there is only one way of bringing this about. The whole money-income of the community must not be expended in buying finished commodities at the end of the industrial process for consumption..." (*ibid.*, p. 48).
Then he continues: "Saving (as distinct from hoarding) does not mean a refusal to apply the money stimulus, but only a refusal to apply it at the retail stage... The first effect of saving, which alone concerns us just now, is thus seen to be a slackening of the former even circulation of money and stimulation of industrial energy, and a substitution of an enhanced circulation and stimulation in certain parts of the industrial system in preparation for a general increased flow of productive energy towards commodities." (*ibid.*, p. 50).

if, instead of lending money to a spendthrift, A invests it in his business or in someone else's business, so as to extend industrial operations, what becomes of the money? Though saved, it is nevertheless spent. But instead of being spent in demanding commodities which, when demanded, are destroyed in consumption, it is spent in demanding productive goods... Such acts of saving employ, directly, *just the same amount of capital and labour* as if the money were spent on commodities, the difference being that in the former case the capital and labor are employed in producing more productive, in the latter in producing more consumptive goods..." [Italics mine... E.E.N.]

"But while it might seem that the opportunities of useful saving were infinite, i.e., that any proportion of the current general income could serviceably be saved *provided* that at some distant time society increased correspondingly its rate of consumption, this is not truly the case..."

The wage lag in the period of rising prosperity preceding the boom is recognized and fitted nicely into the Hobsonian over-saving crisis as an added factor of maldistribution intensifying excessive saving.[25] Similarly the lag in investment at the peak of prosperity is recognized and fitted in.[26]

On the precise question of the determination of the appropriate ratio between social saving and expenditure, Hobson says:[27]

"If this proportion is exceeded one year, it must be curtailed the next, so that over a term of years a real proportion must be maintained between saving and spending... *Though the proportion of efficacious saving to spending is always changing*, at any given time it must rightly be regarded as fixed in the sense that there is an exact proportion of the current income which, in accordance with existing foresight, is required to set up new capital so as to make provision for the maximum consumption throughout the near future. Any miscalculation or other play of social forces which disturbs this pro-

[25] *Rationalisation and Unemployment, op. cit.*, p. 39; *The Economics of Unemployment, op. cit.*, p. 84.

[26] *The Economics of Unemployment, op. cit.*, p. 64. This lag in investment corresponds to the usual concept of "hoarding."

[27] *The Industrial System, op. cit.*, p. 53.

> portion, inducing either too much saving or too much spending, causes a waste of productive power and a restriction in aggregate consumption." [Italics mine—E.E.N.].

These rather extended sections from Hobson have been set out to bring forth clearly certain elements in Hobson's analysis. Throughout his work, Hobson minimizes the possibility of substitution between capital and labor, and of using them in different proportions. In short, he assumes a very simplified production function. While Hobson in some parts of his works is aware of the problem of changing proportions of labor and capital (e.g., in considering the question of the effect of labor-saving machinery), these questions are not fully integrated into his general presentation of underconsumption.

For Hobson, the mutual interaction processes adjusting miscalculations of demand for products, or adjusting the "temporary" unbalance which may be caused by hoarding, or even adjusting miscalculations of investment arising from unforeseen changes in the arts, are somehow independent of the main problem of spending and saving.

In tracing through investment funds Hobson recognizes these as cost payments to ultimate factors of production and thus consumer demand. Likewise he admits the possibility of an inflationary effect from an increase in the rate of saving pending the flow of increased production from the new investment,[28] though this may be attributed to miscalculation between industries.[29]

In an early work, Hobson gives the sequence of events in the cycle:[30]

> "Our saving class is therefore not necessarily causing an increase of 'employment' by paying workers to put up more factories instead of using their moneys to demand consumables. So long as the 'saving' is actually in progress—i.e., so long as the factory and machinery are being made,—the net employment of the community is just as large as if the money

[28] *The Problem of the Unemployed* (London: Methuen, 1896), p. 80f, and *Gold, Prices and Wages* (London: Methuen, 1913).
[29] *Property and Improperty* (London: Gollancz, 1937), p. 45.
[30] *The Problem of the Unemployed, op. cit.*, p. 79f. Cf. Evsey Domar, "Expansion and Employment," *American Economic Review*, vol. 37, pp. 34–55 (1947) where the same point is made.

were spent to demand commodities; more labor is engaged in making factories, less in working them. But after the new factories are made, they can only be worked on condition that there is an increase of consumption corresponding to the increase of producing power—i.e., on condition that a sufficient number of persons are actuated by motives different from those which animated the 'saving' class, and will consent to give validity to the saving of the former by 'spending' on commodities an increased proportion of their incomes. Where no such expectation is realized, an attempt to 'operate' the new factories does not give any net increase of employment, it only gluts the markets, drives down prices, closes the weaker factories, imparts irregularity to work, and generally disorganizes trade."

Hobson locates the down-turn more specifically:[31]

> "These results [unemployment, price fall, etc.] of over-saving are not, of course, made manifest at once. So long as the over-saving is being stored in new plant or machinery and so long as this new plant is engaged in turning out increased supply of goods, there is no reduction of employment and no fall of general prices. It is when the admitted glut of goods checks further investment and oversaving can find no vent that prices fall, production is slackened and unemployment shows itself."

The crisis occurs when the machinery of production is so glutted that attempted saving takes shape in the massing of "loanable capital" unable to find an investment.

The factor of maldistribution of income as the cause of the crisis, to which Hobson adheres tenaciously, must be reconciled with a "pure" over-saving hypothesis. Is there not a question whether, regardless of income distribution, there is a chronic tendency to over-save, or is the over-saving to be attributed entirely or essentially to the income maldistribution?

In his earlier works,[32] as has been said, Hobson does not em-

[31] *Ibid.*, p. 82.

[32] E.g., *The Problem of the Unemployed*, *op. cit.*, p. 82: "Because an individual or a class of individuals can 'save' without any other limit than that imposed by

phasize income distribution as *the* cause of over-saving but deals more particularly with the distinction of saving by an individual vs. saving by an economy, recognizing a chronic tendency to over-save, independent of income distribution.

From *The Industrial System* in 1909, however, Hobson clearly stresses income maldistribution:[33]

> "Now my proposition is that the existence of a 'surplus' income not earned by its recipients and not applying any normal stimulus to industry, has the effect of disturbing the economical adjustment between spending and saving, and of bringing about those periodical congestions and stoppages of industry with which we are familiar."

The trouble arises from the fact that while earned income which is saved involves a careful weighing of present and future pleasures, unearned income ('surplus') is subject to no such nice calculation, the amount going automatically into saving.[34] Hence regarding his policy of redistribution of incomes:

> "Is it not rather obvious that this increased demand due to a readjustment of income (through higher wages or public finance) providing and requiring, as it would, increased employment alike of capital and labour, would so stimulate the operation of industry as to validate at least as large an absolute quantity of saving as before, though a smaller proportion of saving to spending has been effective?"

Hobson does recognize that with growing consumption there can

the necessity of living, it has been wrongly supposed that the same rule holds good of a whole community. This blind individualistic conception of industry was aided by the recognition of the moral and material value which attaches to the exercise of effectual thrift by individual members of a society, and which within the limits imposed by the aggregate consumption must be recognized as necessary and beneficial to society."

[33] *Op. cit.*, p. 284.

[34] *Rationalisation and Unemployment*, *op. cit.*, p. 47. The quotation below is *The Industrial System*, *op. cit.*, p. 285. There seems to be in Hobson a foreshadowing of the Duesenberry hypothesis that the ratio of saving to income is a function of the current income in relation to the highest income previously reached. James D. Duesenberry, *Income, Employment and Public Policy* (New York: Norton, 1948), ch. iii and *Income, Saving and the Theory of Consumption* (Cambridge: Harvard, 1949), ch. v. At least Hobson's changing ratio of saving to income through the cycle and the growth of population and technique validating a higher saving both indicate that he is reaching in this direction.

be growing saving, and he is insistent upon distinguishing between the absolute amount of saving and the ratio of saving to consumption in this connection. This rather clearly implies some idea of a function and schedules. Having arrived at this point, however, Hobson makes no further use of the discovery. As far as he goes is the proposition[35] that "The saving of a smaller proportion of a much larger real money-income by a more widely distributed prosperity would be better guarantee of a harmonious adjustment of production to consumption than the present inequality admits."

He does recognize what he calls "the ill-considered distribution of savings or investment money as between the instrumental and the final industries (as Mr. D. H. Robertson appears to hold) or between fixed and circulating capital (Professor Birck's contention)" as being in part responsible for disequilibrium.

There is much similarity between Hobson's description of the capitalistic process of production in *The Industrial System* and the entire presentation of Aftalion,[36] including the diminishing possibilities of substituting capital for labor as production expands and the diminishing value of additional consumers' goods with increased production. There is even in Hobson an acceleration principle such as Aftalion presents.

It must be taken as Hobson's final position that the maldistribution of income is the cause of over-saving and that there exists no other chronic tendency for consumers to over-save.[37] Accordingly he sees in equalization of incomes increased stability through shifting volumes of consumption from luxuries to

[35] *Rationalisation and Unemployment, op. cit.*, p. 56. The following quotation is from the same page.

[36] Albert Aftalion, *Les Crises periodiques de surproduction* (Paris: M. Rivière, 1913) 2 vols. Had Hobson not blocked his own thinking by the emphasis on the inability to forecast future production modes, he might have probed into the more modern views that scarcity of labor and land make the marginal productivity of capital fall, or alternatively that the risks of enlarging the capital stock deter investors.

[37] *Rationalisation and Unemployment, op. cit.*, pp. 7, 31, 37, 47, 55. It must be conceded, however, that he *formally* recognizes both elements: when he speaks of consumption as an art that is slower to develop than the art of production. *Economics of Unemployment, op. cit.*, p. 32. And yet Hobson sensed, *Rationalisation and Unemployment, op. cit.*, p. 29, that much over-saving could be attributed to the institutional character of corporations and their tendency to over-save, particularly where escape of income taxes might be involved.

staple goods; he views this not so much as a dampening of the amplitude of thc cycle but as striking at its cause just as the reduction of saving does. For "In every period of depression saving is diminished more than spending. This applies not only to the wage earners whose total contribution to the general fund of saving is never very large, but to the propertied and employing classes, whose large automatic savings are to a large extent virtually cancelled by a trade depression."[38]

There is difficulty here. Hobson had argued that particularly through the monetary consequences *after* the downturn[39] the very rich received a smaller proportion of the reduced income (which is true as pointed out below, Table III, p. 136). What reason is there to believe that the rich will now spend (for consumption) a higher proportion of their incomes than in good times?[40] The facts do not support this as Table I, p. 82, shows. It is the poor whose ratio swings more to spending through a fall in savings. Hobson still has the argument of obsolescence of plant to stand on, however.

In support of his argument, Hobson gives only the following:

To establish that the "aggregate of savings depends upon the distribution of the total income, and that the proportion of saving rises with the size of income," he quotes[41] from Stuart Chase, *The Economy of Abundance*, p. 143:

[38] *Economics of Unemployment, op. cit.*, p. 56.

[39] *The Industrial System, op. cit.*, p. 293 and *Economics of Unemployment, op. cit.*, p. 92 where Hobson says that depressions are "worked out by a period of low production and low profits in which the reduced product is distributed favorably to labor, unfavorably to capital, so that the rate of saving is temporarily depressed and the insistence of consumers on retaining as much as possible of its [sic] normal rate of consumption gradually depletes the congested stocks."

[40] In *Property and Improperty, op. cit.*, pp. 50f, he puts it in this way: "...it is important to distinguish the several stages of the cycle; first, the diversion of an excessive proportion of income into the creation of new capital; second, the discovery of this excess registered in unsold stocks of consumer and capital goods; third, the shrinkage of incomes, both of workers and of capitalists; fourth, the reduction of the rate of saving and the letting down of existing plant; fifth, the beginning of what may be called a national recovery."

[41] *Ibid.*, p. 41. The most recent consideration of the effect of income redistribution on consumption is Bronfenbrenner, Yamane and Lee, "A Study of Redistribution and Consumption," *Review of Economics and Statistics*, vol. 37, pp. 147–159 (1955) where the modern literature is critically examined.

Income group	Spending	Saving
Over $1,000,000	$ 87 millions	$ 1,045 millions
$50,000 to $1,000,000	2,494	2,695
$5,000 to $50,000	12,145	3,236
$2,000 to $5,000	21,209	3,276
Under $2,000	53,139	2,291
Institutions	1,799	—
	90,873	12,543

and to establish the falling of the rate of savings in depression below the level needed in normal times to supply new capital goods he quotes[42] from Stuart Chase using *Business Week* (for the United States):

Year	Gross Savings (all in billions)	Total Capital Outlay*	Plant Additions	Corporate Net Profits
1909	4.5	5.0	4.2	2.9
1912	6.3	6.3	5.4	3.5
1915	7.5	6.7	5.8	4.3
1918	11.4	14.9	12.0	6.6
1920	16.4	19.4	12.4	5.9
1922	15.4	15.0	12.2	4.8
1924	17.9	16.0	13.0	5.4
1926	19.0	18.8	14.2	7.5
1928	21.6	21.0	15.3	8.8
1929	24.8	19.2	15.3	10.8
1930	13.7	9.9	8.2	1.4
1931	6.7	2.1	5.9	−1.7
1932	7.1	−3.3	3.3	−6.6

*Includes additions to working capital and foreign loans as well as plant.

These data are, of course, too crude really to establish Hobson's propositions in addition to being highly inaccurate by more recent standards. Cursory comparison with Table I, p. 82 will show wide discrepancies.

The materials in Table I support two hypotheses of Modigliani:[43] (1) that in the long-run, the saving-income ratio depends

[42] *Ibid.*, p. 50.

[43] Franco Modigliani, "Fluctuations in the Saving-Income Ratio: A Problem in Economic Forecasting," in *Studies in Income and Wealth*, vol. 11, pp. 371–443 (New York: National Bureau of Economic Research, 1949). At pp. 384f, he argues: "Our long-run hypothesis at first may appear entirely unrealistic. Casual observation, fully confirmed by budget studies, reveals that the rich save more than the poor. However, both everyday experience and budget data relate to the behavior of different people at the same point of time, whereas

TABLE I

SAVING-INCOME RATIOS BY GROUPS IN THE UNITED STATES, 1919–1945

	(1) Natl. Inc.	(2) Net capital formation	(3) (2) as % of (1)	(4) Saving-income ratios Top 1%	(5) Top 2&3%	(6) Top 4&5%
	In billions current prices					
1919	64.2	10.3	16.0	42.1	25.8	21.6
1920	74.2	11.4	15.3	41.9	25.8	21.6
1921	59.4	3.3	5.5	43.1	29.5	25.4
1922	60.7	4.5	7.4	42.8	28.0	25.8
1923	71.6	8.6	12.0	42.1	28.6	22.8
1924	72.1	5.9	8.1	42.5	28.6	24.0
1925	76.0	9.3	12.2	42.9	28.6	25.0
1926	81.6	9.2	11.3	42.9	28.3	24.6
1927	80.1	8.2	10.2	43.2	28.6	25.0
1928	81.7	7.4	9.0	43.3	28.3	25.4
1929	87.2	10.0	11.5	43.3	28.6	24.6
1930	77.2	4.2	5.4	42.8	28.6	25.4
1931	60.3	0.1	0.2	42.8	29.5	27.0
1932	42.9	−4.2	−9.7	42.7	30.0	27.3
1933	42.2	−3.6	−8.6	42.3	29.2	27.3
1934	49.5	−2.6	−5.2	41.9	28.9	26.2
1935	54.4	.7	1.3	41.9	28.6	25.8
1936	62.9	5.4	8.5	42.5	28.0	25.4
1937	70.5	6.4	9.0	42.2	28.0	25.0
1938	65.5	2.9	4.4	41.4	28.6	25.4
1939	72.4	4.5	6.2	41.7	28.6	25.0
1940	80.7	8.5	10.5	41.5	27.7	24.6
1941	99.0	17.5	17.8	41.2	27.4	23.4
1942	121.2	31.3	25.8	39.8	25.8	21.0
1943	138.4	39.0	28.2	39.1	24.6	20.3
1944	Not available on same basis as			37.9	23.4	17.0
1945	preceding years			38.4	24.0	17.0

Cols. (1), (2), (3), (11) and (12) from Simon Kuznets: *National Income and Its Composition* (New York: National Bureau of Economic Research, 1941) table 39, p. 276; 1939 to 1943 from his *National Product Since 1869* (New York: National Bureau of Economic Research, 1941), table I, p. 17 and table I p. 18. Kuznets does not include capital gains as income.

Cols. (4), (5), (6), (7) and (8) from Simon Kuznets, *Shares of Upper Income Groups in Income and Savings* (New York: National Bureau of Economic Research, 1950) table 17, p. 46. Col. (8) includes entrepreneurial savings as do

(7) % Natl. inc. saved by top 5%	(8) % Natl. inc. saved by all population	(9) % Natl. inc. saved by bottom 5%	(10) Saving-inc. ratio of bottom 95%	(11) Corp. sav. In billions Current Prices	(12) Govt. sav. In billions Current Prices	
8.8	16.5	7.7	10.4	1.0	−1.3	1919
8.6	9.7	1.1	2.8	2.2	1.9	1920
11.3	2.7	−8.6	−12.6	1.7	1.0	1921
10.7	5.6	−5.1	−8.6	0.2	0.9	1922
9.6	8.4	−1.2	−1.7	1.0	1.6	1923
10.1	5.1	−5.0	−7.0	0.4	1.7	1924
10.6	9.0	−1.6	−2.3	0.8	1.6	1925
10.6	5.9	−4.6	−6.3	2.3	2.2	1926
11.1	6.6	−4.5	−6.5	0.6	2.3	1927
11.5	5.6	−5.9	−8.7	0.9	1.9	1928
11.4	7.2	−4.2	−6.1	1.5	2.2	1929
10.8	3.6	−7.2	−10.6	−0.7	2.1	1930
11.3	4.6	−6.7	−9.9	−3.1	0.3	1931
11.4	3.5	−7.9	−11.6	−4.8	−0.9	1932
10.7	1.2	−9.5	−13.8	−4.0	−0.1	1933
10.0	−2.6	−12.6	−18.0	−3.3	−0.6	1934
9.8	8.5	−1.3	−1.8	−2.1	−1.7	1935
10.2	13.2	3.0	4.3	−0.7	−2.2	1936
9.8	10.3	0.5	0.7	−1.4	0.5	1937
9.4	8.8	−0.6	−0.8	−0.7	−0.2	1938
9.5	3.7	−5.8	−0.8	4.2	n. a.	1939
9.1	4.6	−4.5	−0.6	4.1	n. a.	1940
8.6	9.7	1.1	−0.2	4.1	n. a.	1941
7.1	21.1	14.0	18.1	3.9	n. a.	1942
6.4	21.8	15.4	19.5	3.3	n. a.	1943
5.5	19.3	13.8	16.7	3.0	n. a.	1944
5.8	15.3	9.5	11.6	3.3	n. a.	1945

cols. (2) through (7). Col. (8) is col. (1) divided by col. (5) of table 39 of Kuznets, *supra*. Top 5% reaches down to $6,680 annual income per family of four (20 year average, 1919–38 of current prices).

Col. (9) is col. (8) minus col. (7).
Col. (10) is the income of bottom 95% (computed from col. (5) of appendix table 2, p. 67 of Kuznets, *Shares of Upper Income, etc., supra*, which is also col. (5) of Table III below) divided into col. (9), for 1919 to 1938 and calculated for 1939 to 1945 from col. (1), (4) and (7) of Table 47, p. 176f of Kuznets, *Shares of Upper Income, etc.*, 1953 edition, and col. (1) of this table.

TABLE Ia

UNITED STATES SAVINGS–INCOME RATIOS IN PERCENTAGES, 1945–1950

Year	Saving–Income Ratio of Total Population	TOP TENTH Share in Sav.	Share in Inc.	Savings–Inc. Ratio	LOWER NINE–TENTHS Share in Sav.	Share in Inc.	Savings–Inc. Ratio
1945	15	46	29	24	54	71	11
1946	12	63	32	24	37	68	7
1947	9	77	33	21	23	67	3
1948	7	78	31	18	22	69	2
1949	5	105	30	18	–5	70	–0.4
1950	8	73	29	20	27	71	3

Source: Simon Kuznets, *Shares of Upper Income Groups in Income and Savings* (New York: National Bureau Economic Research, 1953) Table 54, p. 216 which is based on "Survey of Consumer Finances" in *Federal Reserve Bulletin*

not on income but on rate of change in income, and (2) in the cycle, the saving-income ratio tends to vary with the stage of the cycle, falling below the secular level as income falls, and vice

our hypothesis concerns the behavior of aggregates in time. There is strong reason to suppose that as aggregate income increases, persons moving into progressively higher income brackets do not tend to acquire the saving habits characteristic of persons formerly in the income bracket; on the contrary, they may tend to save less. Indeed, it can easily be demonstrated that the hypothesis that they save as much would lead to rather absurd results. Our tentative conclusion is, in fact, supported by a careful analysis of American budget material by Dorothy S. Brady and Rose Friedman. ["Savings and Income Distribution," *Studies in Income and Wealth*, vol. 10, (New York: National Bureau of Economic Research, 1947)]. The reason persons in each income bracket tend to save less as aggregate income rises secularly, and the plausibility of our long-run hypothesis become apparent when one considers the nature of economic progress. Economic expansion is not characterized by the availability of increasing quantities of the same commodities, but rather by the continuous improvement of many old commodities and by the continuous appearance of entirely new ones. If consumers had no choice except to spend their increasing income on more and more of the very same commodities, then indeed it would not be surprising to find at least some relative increase in saving as income rises... Thus, the hypothesis that the saving-income ratio tends to be relatively independent of the secular expansion of income (that is, in comparison with its cyclical behavior) is not unrealistic and also is not inconsistent with, but is supported by, budget data.

"With respect to our cyclical hypothesis, there are numerous supporting factors. We confine ourselves here to considering briefly the three that seem to be quantitatively most important: a) cyclical changes in income distribution, b) rigidity of acquired consumption habits, and c) fluctuations in the level of employment."

versa. It will be noted that the second is also Hobson's thesis.

With regard to the right ratio of spending and saving, Hobson argues:[44]

> "In a stable society, as we saw, all the income net of depreciation and replacement is spent: there is no place for saving. But in a progressive society where the future rate of consumption is to exceed the present, for a larger population with a higher standard of comfort, saving is essential... *The right amount of saving out of a given income, i.e., the right proportion of saving, will be determined by the amount of new capital needed to furnish a given increase of consumption goods.* Over a period of years there will be a rate of saving which will assist to produce the maximum quantity of consumption goods." (Italics mine—E.E.N.)
>
> "The right proportion of saving to spending at any given time depends upon the present condition of the arts of production and consumption, and the probabilities of such changes in modes of work and living as shall provide social utility for new forms of capital within the near or calculable future."

There is only one "right" ratio of spending and saving (i.e., a ratio calculated to maintain full employment of the factors) when the variable to be maximized has been determined, together with the conditions underlying the maximization process. That is, once there is a prediction of goods to be consumed in the future and the technology to be available, it is possible to determine what capital goods (abstracting from monetary phenomena) will be required to carry out the program, under any given production function, and further assuming that the time schedule for consumption reflects anticipated postponement acceptable to the consumers.

When Hobson says:[45]

> "The right amount of saving out of a given income, i.e., the right proportion of saving, will be determined by the amount

[44] *The Industrial System, op. cit.*, p. 54.
[45] *Ibid.*

> of new capital *economically needed to furnish a given increase of consumption goods.*"

he is anticipating the theory of economic growth more fully to be developed by Harrod and Domar[46] among others.

In Hobsonian terms, however, we should specify what is not mentioned in Hobson: that "the given increase of consumption goods" must include in consumption goods: leisure, the satisfactions of liquidity, the satisfactions of stability, the pursuit of equalization of income distribution at the possible expense of a maximum physical total output, etc.

4. NEGLECT OF MONEY AND CREDIT FACTORS

While Hobson is aware that trade-cycle arguments may be based on hoarding as a crucial factor, he does not agree, but says rather:[47]

[46] *E.g.*, Evsey D. Domar, "The 'Burden' of the Debt and the National Income," *American Economic Review*, vol. 34, pp. 798–827 (1944) and "Expansion and Employment," *ibid.*, vol. 37, pp. 34–55 (1947), and "Capital Expansion, Rate of Growth and Employment," *Econometrica*, vol. 14, pp. 137–47 (1946); R. F. Harrod, *The Trade Cycle* (Oxford: University Press, 1936), "An Essay in Dynamic Theory," *Economic Journal*, vol. 49, pp. 14–33 (1939) and *Towards a Dynamic Economics* (London: Macmillan, 1948). Joan Robinson, *Collected Economic Papers* (Oxford: Blackwell, 1951) says at p. 167: "Mr. Harrod's analysis provides the missing link between Keynes and Hobson." She refers to Harrod's recognition of the rate of interest (which, however, Harrod like Hobson assumes to be constant through most of his analysis) and money and their ramifications.

It is a little strange that Hobson did not develop the hypothesis of Mrs. Robinson that "The general pattern of interest rates depends upon the distribution of wealth between owners with different tastes [for speculation and liquidity] relatively to the supplies of the various kinds of assets." Joan Robinson, *The Rate of Interest and Other Essays* (London: Macmillan, 1952), p. 9. This hypothesis denies 1) the significance of *the* rate of interest and 2) the efficacy of monetary controls, and likewise fortifies the Hobsonian key: maldistribution of income. Similarly Mrs. Robinson's remarks later at p. 83: "Thus not the amount, but the distribution of saving in one period has an influence upon the course of investment in the next."

[47] *The Industrial System, op. cit.*, p. 41 and again in *Rationalisation and Unemployment, op. cit.*, p. 33.

Schumpeter in his *History of Economic Analysis* (Oxford: Univ. Press, 1954) at p. 108 ascribes to Hobson an appreciation of the significance of hoarding. He cites *The Physiology of Industry* but fails to realize that co-author Mummery must be responsible for this statement since Hobson, as just indicated, rejects this line of thinking.

> "In primitive societies, or in disturbed conditions of more advanced societies, much refusal to spend takes the form of hoarding money... An increase in hoarding inevitably tends to depress trade, though the subsequent spending of hoarded treasure, will ultimately redress the balance by affording a corresponding stimulus. In modern industrial societies, however, hoarding is abnormal."

In a footnote he adds at this point: "In a later discussion of commercial depressions, and their accompanying unemployments, we shall perceive that abnormal hoarding may sometimes play a critical part." In that later discussion, hoarding is treated as secondary and consequential after depression has set in for the underconsumptionist causes Hobson stresses.[48] While this in itself is orthodox with respect to hoarding, Hobson argues that the hoarding is not to be attributed to a speculative motive of anticipation of still lower prices but to the accumulation of funds due to default of profitable investment opportunities:[49]

> "It is when the admitted glut of goods checks further investment and over-saving can find no vent that prices fall, production is slackened and unemployment shows itself."

Similarly, in the case of the banking system, he recognizes the "mysterious ways in which these bank credits are created, increased or contracted"[50] but he persists in analyzing bank credit effects only in "normal" situations where "No inflation or rise of prices is attributable to their [banks'] normal working."[51] He makes this statement although he recognizes the rationing effects of bank credit as between various industries: "Bearing in mind

[48] *The Industrial System, op. cit.*, ch. xviii. This represents a considerable shift from his early views: "The possibility of withholding Demand only arrives with the use of some forms of money, by the ownership of which power to demand may be held in solution as a lien upon the future. In other words the use of money is a necessary condition to that failure of demand to keep full pace with the growth of supply which is expressed in a fall of prices. But no proof is forthcoming that there is in fact anything which can rightly be called "scarcity" of money, or how such "scarcity" increases the tendency of owners of demand power to withhold that power." *The Problem of the Unemployed, op. cit.*, p. 124.

[49] *The Problem of the Unemployed, op. cit.*, p. 82.

[50] *Rationalisation and Unemployment, op. cit.*, p. 50.

[51] *Ibid.*, p. 51.

that normally the apportionment of productive energy if trade prospects are favorable to a state of trade which requires for its financing a larger volume of bank credits,"[52] is done by banks.

In short, Hobson argues that if there were no *real* explanation of the cycle in terms of maldistribution of incomes causing disequilibrium between saving and consumption, neither hoarding, dishoarding nor bank credit elasticity could cause important fluctuations. He argues[53] that the maladjustments which other economists attribute to hoarding and bank credit disequilibrium are due initially, in the order of causation, to miscalculations between industries in anticipating consumers' actions. This is a typical reaching for a *real* explanation rather than a *monetary* explanation. It is true that it is orthodox to premise entrepreneur pessimism in the monetary area on some *real* change causing entrepreneur psychology to shift, but Hobson goes beyond this and in effect argues that the whole causation flows from the real phenomenon.

In his later years, Hobson finds[54] that "a suspicion of disharmony between [the interests of the banking industry and the interests of economic society as a whole] is aroused by the fact that banking has remained in its highest prosperity during the deepest and most prolonged industrial depression." He then recognizes the possible bad effect of credit expansion in inducing security speculation.

But fundamentally, Hobson can see no necessary objection to credit expansion, since "*Where these increases of credits are of such a nature that they cannot be anticipated by the price activities of the business world*, they rank for the time being as pure creation of purchasing power... As they compete with... actual monetary savings in the markets for goods and services, they raise prices and enable non-savers to get a portion of the real savings away from savers..."[55]

[52] *Ibid.*, p. 53.
[53] *Economics of Unemployment*, *op. cit.*, pp. 108–118 and *Rationalisation and Unemployment*, *op. cit.*, pp. 51–55.
[54] *Rationalisation and Unemployment*, *op. cit.*, p. 54.
[55] *Ibid.*, p. 52. Italics mine—E.E.N.

With this, Hobson stops short, not undertaking the further possibilities that he has just very broadly hinted at.[56]

His final position is:[57] "The attempts of economists and statesmen to conceal the nature of this failure of capitalism by citing as its causes monetary and protective disturbances which are actually effects and owe their origin to the failure of producers to win markets for all they can produce, is a cowardly refusal to face the political and economic reforms needed."

Hobson, in a consideration[58] of the effect of falling price levels, attacks the type of argument which is today summarized as "the Pigou effect"—that the increased real value of assets following a wage and price decline causes an upward shift in the consumption function and hence the elimination of unemployment. The Pigou effect is recognized as a theoretical possibility but not in accord with "the ordinary motives of men."

4a. ANOMALOUS DISCUSSION OF MONEY, CREDIT AND INFLATION

It was suggested in Chapter II that during the period 1902 through 1918, Hobson had permitted underconsumption to lie dormant and that the reason for this may well have been the continuous rise in the price level which began in England about 1895 after the fall in prices from 1873 to 1895.

In this period, Hobson wrote *Gold, Prices and Wages*, the only work in which he devotes any extended discussion to money. The touchstone of this 1913 volume is the matter of the rise in the price level which began in 1895 and the refutation of the argument that inflation is due to an increase in gold, which causes an increase in credit and a resulting increase in prices via a bald

[56] Indeed, the entire section, *ibid.*, pp. 49–55, indicates that at last (1930) Hobson recognizes the monetary assumptions under which he worked but at the age of 72 years it was too late to develop this area. But even in *Property and Improperty*, *op. cit.*, p. 48 he adheres to his original position: "It is, of course, true that in the beginning of a depression, the actual over-production of consumer goods suggests a lack of money in the hands of would-be purchasers. *But that lack registers the second stage in a maldistribution of money income.*" (Italics mine—E.E.N.).

[57] *Property and Improperty*, *op. cit.* p. 131.

[58] *Economics of Unemployment*, *op. cit.*, pp. 55f. Hobson had earlier rejected the Pigou effect in *The Physiology of Industry*, *op. cit.*, p. 128.

quantity theory argument. The criticism by Hobson, however, is framed within the neo-classical tradition: that the effect of money and credit is almost entirely on prices and not at all on output. Hobson's argument is that this inflation resulted from the dual operation of acceleration in the supply of money and retardation in the supply of goods. On the money side, Hobson points to increased investment demand in America and an increase in quantity and velocity of money through an increased use of banks by lower income groups together with the increased facility of credit due to development of the security markets. On the goods side, the supply of consumption goods was reduced by (1) increase in unproductive government expenditures, (2) wastes of competition, (3) temporary stress on industries of diminishing returns, (4) increased armaments, (5) increase in luxury items, (6) high tariffs, and (7) capital and labor monopolistic practices. The inflation would end when American output flowed from the new investments.

There is a discussion of forced saving. Banks shift assets into long-range capital developments, especially foreign investment, at the expense of domestic production here and now.

The orthodox "gold" argument is attacked for assuming a constantly increasing demand for loans, whereas a large part of the demand for gold in this period was to bolster weak currencies. Further, the gold argument proceeds by a chain of increased gold, lower discount rates, higher wholesale prices, higher retail prices and higher wages. Actually, gold output increased continuously from 1873—but prices fell from 1873 to 1895 and then rose.[59]

5. NEGLECT OF INTEREST RATE ADJUSTMENTS

Hobson gives very little attention to interest rate adjustments, the classical method of adjustment both of the underconsumption problem and (together with wage rate adjustments) of the

[59] The more refined analysis of Cassel uses a "normal" annual increase in gold supply of 2.8% and develops the relative gold stock concept in which the fall in relative gold supply from 1873 to 1895 coincides with the price level fall and thereafter the two rise hand in hand. Gustav Cassel, *The Theory of Social Economy*, English trans. by Barron from 5th ed., (New York: Harcourt, Brace & Co., 1932), at p. 469, figure 3.

cycle problem. Most of his discussion of interest rates in the cycle is in *The Problem of the Unemployed*,[60] published in 1896, where he argues that during the period when savings are being expended on construction there are no adverse effects on the economy.

> "But after the new factories are made, they can only be worked on condition that there is an increase of consumption corresponding to the increase of producing power—i.e., on condition that a sufficient number of persons are actuated by motives different from those which animated the 'savings' class, and will consent to give validity to the saving of the former by 'spending' on commodities an increased proportion of their incomes. Where no such expectation is realized, an attempt to 'operate' the new factories does not give any net increase of employment, it only gluts the markets, drives down prices, closes the weaker factories, imparts irregularity to work, and generally disorganizes trade."

He does not, however, point out that the increase in saving (reduced current demand for consumers' goods) may be reconciled with incentive to the entrepreneur to expand investment through a fall in the rate of interest, which lowers the unit cost of more capitalistic means of production. He eliminates the interest rate from consideration on the ground that it reacts too slowly to be significant in its effect.[61] Hence there is no real basis for calculation of the "cut-off" point in the future at which "efficacious saving" must cease or change its rate pending new technological or other changes. Hobson recognizes a diminishing return sche-

[60] *Op. cit.*, p. 79f.

[61] *Economics of Unemployment, op. cit.*, pp. 51–57, esp. p. 53; *Rationalisation and Unemployment, op. cit.*, p. 47; *The Problem of the Unemployed, op. cit.*, p. 82. It is true that isolated statements can be found such as: "For much saving is, indeed, regardless of the rate of interest, an almost automatic setting aside of surplus income, while some private saving is even stimulated by a lower rate of interest when the motive of the saving is some fixed provision for the future." *Rationalisation and Unemployment, op. cit.*, p. 47. Savings of the poor are insensitive to the interest rate; savings of the rich likewise (habitual); savings of the middle class in part inverse to the rate (precautionary) and in part direct with the rate. This would summarize Hobson's position.

dule for investment determined by technology and expectations at any given time; but the rate of interest and a supply schedule for investment funds are missing. The supply schedule for investment funds is assumed not sensitive to interest rate change. Also, Hobson's position on the interest rate depends heavily on his view that deepening of capital is not significantly possible on the demand side.

Hobson illustrates his argument in this way. When considering the proposition that a "net loss of employment over a long period is caused by underconsumption and not merely a maldistribution of employment," he states a hypothetical case. Commencing with an economy in which there is the "right economic relation between forms of capital and rate of consumption," he assumes an increase in saving by investment in cotton mills from reduced cotton consumption. Former cotton-mill operators now build a cotton-mill for a year: no change in employment. Applying the new saving to the cotton trade where quantity demanded is absolutely reduced does not affect the problem. Nothing happens to employment as long as the savers are content with cotton-mills instead of cotton. In the second year, assume the same saving and the funds applied to operating the new mills. Assuming the output is not placed on the market, no change in employment. Now let it be assumed the savers use banks throughout. In the second year after the banks realize the over-production, when the goods are marketed, prices fall and then the banks refuse to continue to furnish funds. The weaker mills stop and unemployment ensues. The total of production falls and real incomes fall. "*This will tend to proceed until the reduced reward of saving* (*real interest*) *gradually restores the right proportion of saving to expenditures—a very slow and wasteful cure.*" In a footnote Hobson adds "an over-supply of capital does not bring down the 'rate of interest', though it reduces the real reward of saving. The effect of putting up unnecessary mills is to lower the capital value of each mill. The rate of interest on this reduced valuation may be the same as before."[62]

[62] *The Problem of the Unemployed*, *op. cit.*, p. 96.
Although Hobson's theory is usually described on the basis of *The Industrial System*, *The Economics of Unemployment* and *Rationalisation and Unemployment* (e.g., by Haberler in his *Prosperity and Depression*, *op. cit.*, and by Hansen

If it is assumed that the reduced "real interest" reduces saving *through affecting the source of savings* (and a large part of saving is by interest-receivers in the Hobsonian system) there is no conflict with Hobson's thesis[63] that supply of saving is interest-inelastic. Thus with the demand curve for loanable funds shifted to the left in the same quantity as the inelastic supply curve of loanable funds, the rate of interest remains the same.

6. NEGLECT OF DEEPENING OF CAPITAL

Associated directly with the simplified production function assumed and the neglect of interest rate adjustments is the failure of Hobson to consider the significance of deepening of capital. He practically cuts off the question of deepening of capital by making two factual assumptions:[64] (1) that the changing arts "very soon result in promoting an increased flow of finished goods" and (2) "the proportion of new saving which can be so applied to fructify at some far distant date is necessarily small, restricted principally by our inability to forecast far ahead either the needs of coming men or the most economical modes of providing for them."

It is true that by 1930 he began some consideration of this question:[65] that "the ill-considered distribution of savings or investment money as between the instrumental and the final industries (as Mr. D. H. Robertson appears to hold) or between fixed and circulating capital (Professor Birck's contention)" is in part responsible for disequilibrium.

in his *Business Cycles and National Income, op. cit.*), it is submitted that *The Problem of the Unemployed, op. cit.*, is the best single reference to give for Hobson's underconsumption, particularly in its chs. v and vi, pp. 56–111.

Something akin to Hobson's view in the text is found in Mrs. Robinson: "Thus the appearance of unemployment must be imagined to reduce the full-employment value of the rate of interest by more than it makes the actual rate fall." Joan Robinson, *The Rate of Interest and Other Essays* (London: Macmillan, 1952), Essay on "The Generalization of the General Theory," p. 74.

[63] *Cf. The Problem of the Unemployed, op. cit.*, p. 116: "An increase of money which was privately hoarded by its possessors could manifestly have no effect on prices. If this was hoarded in banks, it could only operate by reducing the rate of discount, thus stimulating the purchases of those who borrow to buy." Thus there is a shift to the right of the inelastic supply curve for loanable funds while the demand curve does not change.

[64] *The Industrial System, op. cit.*, pp. 51–53.

[65] *Rationalisation and Unemployment, op. cit.*, p. 56.

In his rejection of the argument that investment can go on without limit, Hobson places emphasis on the dependence of profitable investment upon the scope of the market for the consumers' goods. While it might seem that investment would, of itself, cause the prices of consumers' goods to fall to such an extent as to enlarge the market and make the correlative additional investment profitable, Hobson maintains the first effect of falling prices is a corresponding fall in money incomes.[66] Without an operative theory of interest rate adjustments,[67] however, he is, at this point, clearly at sea. It is a question of increased revenue from the price fall (factor payments) versus cost of the additional investment.

In 1930 Hobson adds[68] an erroneous attack on the idea that there is a lag[69] between investment (money distribution) and the time when the goods which this money will buy are produced, contending that the getting of the money to the hands of the consumers through various stages of purchase of capital goods takes as long as the ultimate flow of goods. This is in conflict with his views in *Gold, Prices and Wages* already discussed. In that volume he attributed the inflation of the early twentieth century precisely to this lag.

Again, in 1937, Hobson shows that the writings of Robertson which he had noted in 1930 were still running through his mind:[70]

> "With every growth of population and every improvement of scientific technique, it seems likely that the amount of saving, and possibly the proportion of saving to spending, would be increased. Against this, however, must be set the

[66] *The Industrial System, op. cit.*, p. 292.

[67] As will pointed out below, § 9, Hobson accepts Böhm-Bawerk's theory of interest in *Economics of Distribution* (New York: Macmillan, 1900). As indicated in the previous section, however, he eliminates interest rate adjustments from underconsumption theory on the ground that the interest rate reacts too slowly. It is a paradox that one with Austrian views on isolated interest theory should neglect deepening of capital! Yet deepening, as a slow process, can be distinguished.

[68] *Rationalisation and Unemployment, op. cit.*, p. 41f.

[69] It has already been noted that Hobson recognized a lag (hoarding) between the act of saving and the investment of saved funds near the peak of the boom. *Rationalisation and Unemployment, op. cit.*, p. 43; *Economics of Unemployment, op. cit.*, p. 64.; *The Industrial System, op. cit.*, p. 291.

[70] *Property and Improperty, op. cit.*, p. 52f.

> increased amount and proportion of spending which, after the due satisfaction of common material needs, will go into demand for such distinctively personal requirements of goods and services as are in their nature less amenable to standardized production, and, therefore, make a smaller call upon saving and new capital... The proportion of income rightly saved will thus be a fluctuating quantity."

But we are left without any possible mechanism of control, except taxation[71], when interest theory is abandoned as it is with the following:[72]

> Surplus "lies in the hands of men who are 'glutted' in comforts and luxuries and therefore let it flow into savings, irrespective of the rate of payment for such savings or the possibility of their useful employment."

Might not the "surplus" (income not sensitive to interest rate changes in its application) be completely soaked up by taxation to the point where all saving would be responsive to interest rate changes and thus a self-equilibrating mechanism established? Even a system abstracting from monetary phenomena must have a theory of the real rate of interest, i.e., of present versus future goods and of productivity versus costs.

7. REJECTION OF MARGINALISM

One important factor to which part of the weakness of Hobson's trade cycle theory can be attributed is his attempted rejection of the marginal principle.[73] His objection is based upon the argu-

[71] *Ibid.*

[72] *Ibid.*, p. 42. To repeat, it is a little strange that Hobson did not develop the hypothesis of Mrs. Robinson that "The general pattern of interest rates depends upon the distribution of wealth between owners with different tastes [for speculation and liquidity] relatively to the supplies of the various kinds of assets." Joan Robinson, *The Rate of Interest and Other Essays* (London: Macmillan, 1952), p. 9. This hypothesis denies (1) the significance of *the* rate of interest and (2) the efficacy of monetary controls, and likewise fortifies the Hobsonian key: maldistribution of income. Similarly Mrs. Robinson's remarks later at p. 83: "Thus not the amount, but the distribution of saving in one period has an influence upon the course of investment in the next."

[73] It is at this point that remarks by J. M. Keynes are most appropriate in his review of *Gold, Prices and Wages* in *Economic Journal*, vol. 23, p. 393 (1913):

ment that businesses and factors of production are organic wholes and cannot be treated realistically by adding or subtracting a unit of a factor: "It [the marginal unit] does not possess any separate productivity so as to produce a separate product."[74] This is based on his misunderstanding of the entire marginal principle.[75]

Other bases on which Hobson rejects the marginal principle are: (1) the "misunderstanding" by the neo-classical school of the Law of Diminishing Returns,[76] through a failure to see that the law means only that *at any given time* certain factors are fixed and hence a peak efficiency exists; this static assumption being then carried over to dynamic questions without awareness of the new conditions, (2) the failure to recognize that the satisfactions of consumption must be correlated with the dissatisfactions of production to get net gain; the recognition of utility (as opposed to cost) analysis on the demand side, but its non-recognition[77] on the supply side, 3) as a consequence or corollary of 2), the separation of economic from non-economic satisfaction when satisfaction is one and inseparable,[78] 4) the ignoring of the various assump-

"One comes to a new book by Mr. Hobson with mixed feelings, in hope of stimulating ideas and of some fruitful criticisms of orthodoxy from an independent and individual standpoint but expectant also of much sophistry, misunderstanding and perverse thought."

Likewise, the remarks of Alfred Marshall, *Principles of Economics* (New York: Macmillan, 8th ed., 1920), p. 409n.: "Mr. J. A. Hobson is a vigorous and suggestive writer on the realistic and social sides of economics: but, as a critic of problems which he discusses... [his] study of changes in complex quantitative relations is often vitiated by a neglect of this consideration [the marginal principle]". Cf. Robinson, *Collected Economic Papers* (Oxford: Blackwell, 1951), pp. 6–8.

[74] *Property and Impropertry*, *op. cit.*, p. 220. Cf. *The Industrial System. op. cit.*, pp. 112–20.

[75] *E.g.*, "Marginal Units in the Theory of Distribution," *Journal of Political Economy*, vol. 12, pp. 449–434 (1904); "Marginal Theory of Distribution," *Journal of Political Economy*, vol. 13, pp. 587–90 (1905); "Marginal Productivity," *Economic Review*, vol. 20, pp. 301–10 and pp. 673–86 (1909); "Neo-classical Economics in Britain," *Political Science Quarterly*, vol. 40, pp. 337–83 (1925).

[76] "Neo-classical Economics in Britain," *op. cit.*, p. 359.

[77] *Ibid.*, pp. 351–53. And because of this, Hobson argues that neo-classical analysis arrives at the conclusion that no unearned surplus can arise and all factors are paid what they are worth. Such an argument would not invalidate marginal analysis but at most the conclusion that all factors are paid what they are worth. In addition, Jevons and others did recognize disutility.

[78] *Ibid.*, pp. 343–44.

tions underlying the usual demand analysis, *e.g.*, income distribution, *etc.*[79]

Hobson carried his rejection of marginalism over to the area of aggregate saving and spending analysis:[80]

> "A similar reasoning [that there is an organic whole] disposes of the greater part of the importance assigned to marginal units of expenditure in the outlay of a consumer's income... Under normal conditions no such calculation is performed... Indeed, the 'organic' nature of a standard of living has a more definite meaning than the 'organic' nature of a productive undertaking."

Thus we find in Hobson no "marginal propensity to consume" and therefore no multiplier—although curiously, we found an acceleration principle in the *Physiology*. Perhaps Hobson's objection to marginalism also accounts for the failure to incorporate an application of the theory of the rate of interest in his underconsumptionism. This rejection of marginalism appears to be made with full knowledge of its import to the savings question, for the preceding quotation was published in 1937 in a volume where Hobson cites Keynes' *General Theory* twice. Hobson wanted to break completely with classical theory as the defender of laissez-faire against which he had valid criticisms and this seems to have warped him into a wrong-headed interpretation of the marginal principle.

8. QUASI-ACCEPTANCE OF SAY'S LAW

While Cole argues[81] that Hobson "challenged effectively the *théorie des debouchés* which had so long dominated economic thought," this is far from clear, and the reverse appears to be true.

Hobson himself says:[82]

> "If all exchange were of commodities with commodities direct, it is clear there could be no over-supply and that the

[79] *Ibid.*, pp. 378–79.
[80] *Property and Improperty*, *op. cit.*, p. 220f.
[81] G. D. H. Cole, "John A. Hobson, 1858–1940," *Economic Journal*, *op. cit.*, p. 358.
[82] *The Problem of the Unemployed*, *op. cit.*, p. 124.

alleged power of supply to create a corresponding effective demand would always be valid... In other words, the use of money is a necessary condition to that failure of demand to keep pace with the growth of supply which is expressed in a fall of prices."

This was written in 1896. Later, in 1930[83] Hobson shifted to minimizing the "hoarding" qualification of Say's Law: "...money-income can only be used to purchase products either consumables or capital goods..." Now he rests the objection to Say's Law on disruption of the saving-spending ratio, that is, Say's Law is admitted only if this ratio is in equilibrium. This position he maintained from 1909:[84]

"If we are dealing with a community fixed in its numbers and its modes, the whole of the money income... would be spent in demanding commodities for personal consumption," since there would be no need for saving.

Even after the appearance of Keynes' *General Theory* he clings to this position.[85]

9. THE ABSTRACT THEORY OF THE RATE OF INTEREST

While Hobson does not integrate any theory of the rate of interest into underconsumption, he does consider interest theory as a thing apart.[86] Hence the term "abstract theory of the rate of interest." Hobson analyzes interest theory in terms of the same conflict between cost and utility which he finds to be the heart of the value problem. In his own language:[87]

"In order that labour may command a price for its use, three conditions are admittedly essential: first, there must be ob-

[83] *Rationalisation and Unemployment*, *op. cit.*, p. 33.
[84] *The Industrial System*, *op. cit.*, pp. 42,47.
[85] *Property and Improperty*, *op. cit.*
[86] *Economics of Distribution*, *op. cit.*, Ch. viii, pp. 227–265.
[87] *Ibid.*, pp. 237–38.

jective or technical productivity, an actual increase of 'goods' due to the use of the labour; secondly, there must be a subjective cost or painful expenditure of effort; thirdly, there must be a subjective utility or fund of enjoyment afforded by the result of the labour.

All three conditions we have shown are present in the case of the functioning of forms of fixed capital. A house or a machine when economically used gives out a continuous supply of objective economic goods to which value is attached, and a 'price' affixed by consideration of the relation between the marginal 'cost' of that abstinence which is essential to secure their economic existence, and that marginal 'utility' which directly measures the economic importance attached to them by borrowers."

Recognized by Hobson as motives for saving are:[88] (1) surplus income accumulation, not sensitive to interest rate change,(2) precautionary, inversely sensitive to interest rate change, and (3) by men of substance to extend their business or position, directly sensitive to interest rate change. But there is no recognition of any liquidity or speculative motive.

Hobson criticizes Marshall for resting the utility aspect on an incomplete statement of "waiting"; it is not a question of present versus future goods as such, but of transferring a marginal unit with its present satisfaction to the future where, regardless of time difference, the marginal utility may be different,[89] and thus in fact the time preference for a given individual may, depending upon his future expectations, be negative.

10. HOBSON ON OTHER THEORIES OF THE TRADE CYCLE

It is characteristic of Hobson that he speaks of a depression in the trade cycle as entirely a problem of unemployment[90] although he

[88] *Ibid.*, pp. 258ff.
[89] *Ibid.*, p. 261. Böhm-Bawerk recognized the point, however.
[90] *The Industrial System, op. cit.*, Ch. xviii.

makes it clear that he uses unemployment to refer to all of the factors of production.

It must be remembered that at the time of *The Physiology of Industry* in 1889 and of *The Industrial System* in 1909, there was not much literature available in English on the trade cycle. It is curious that Hobson seldom cites any of the other underconsumptionists who preceded him.[91] In fact, his discussion of other theories of the trade cycle is very short and incidental[92] and he does not consider any particular economist's theory as such.

With regard to "natural causes" as the explanation of the trade cycle, Hobson says:[93]

> "Even in an industrial society where all the acts of production and all the standards of consumption were either stationary or else changed with slow and calculable regularity, climatic and other natural influences affecting crops and other raw materials must have some considerable effect in determining the volume and the regularity of the employment of the factors...
>
> "Every expansion in the area of the market for raw materials and for products evidently diminishes the aggregate waste of industrial energy from these natural causes.
>
> "The notion... that the great periodic depressions of industry and employment in such a country as England are even now directly attributable to failures of harvests, will not stand investigation."

He argues that after a short crop "Some dislocation of trade may fairly be attributed to the change of distribution of income, but there is no reason to assume that the aggregate of spending or of employment will be less" either as a result of cutting the incomes of wheat handlers for example, or as a result of an argument that a larger share of income goes to wheat buying, thus drawing income from other trades.

[91] Referring particularly to Sismondi, Lauderdale, Malthus, Rodbertus and Marx, of whom he considers only Marx and then only to reject his labor theory of value. Malthus is only mentioned in *The Physiology of Industry*, *The Evolution of Modern Capitalism*, *The Problem of the Unemployed* and *Confessions of an Economic Heretic*.

[92] Primarily in ch. xviii of *The Industrial System*, *op. cit.*

[93] *Ibid.*, p. 274.

It is at this point that we again see the validity of the comment of Marshall[94] about the fallacy in Hobson's believing that a small quantitative change can not have great significance at the margin. Hobson argues that the variation of wheat production, in which there is a world market, is at a maximum of 10%, and considering the per cent of total income of a country such as England with less than 10% coming from wheat, the change in national income attributable to a short crop is too small—and further, unemployment does not correlate well with crop failures whatever lag may be used. In this connection, he makes no allowance for "normal" or "frictional" unemployment as is done today, but uses total unemployment figures.[95]

Hobson concedes that *some* general unemployment may arise from a short crop in agriculture in this way: the quantity of wheat others can get by employing their capital and labor is reduced and they let some of their investments go idle because of (1) reduced purchasing power of the profit in terms of wheat, and (2) reduced dollar profit due to higher wage demands from the working-class who consume wheat. He does not realize, however, that if the elasticity of demand for wheat products is high (as opposed to the elasticity for wheat), the cumulative process might amount to a substantial percentage of unemployment such as to produce secondary effects based on the initial unemployment.

Hobson then considers the introduction of labor-saving machinery as the cause of the trade cycle. Unless it is drastic and unforeseen, there can be no more than frictional unemployment. Whether there will be net unemployment in any given industry through introduction of labor-saving machinery he recognizes as determined by whether the demand for the product is elastic (substantial unemployment) or inelastic (little unemployment). Even in the elastic demand case, expenditures elsewhere may restore employment. Hobson agrees with Marshall that the intro-

[94] Alfred Marshall, *Principles of Economics*, *op. cit.*, p. 409n.

[95] There are a number of qualifications on the statistics used by Hobson, namely world wheat production annually compared with total unemployment in percentages annually (apparently for Britain). Hobson recognizes correction for lag, population trend and demand shift. He does not mention inventory-carryover, near substitutes, etc. Hobson also compares unemployment with indices of food, materials and total prices and finds no correlation. The correlation would not, of course, be direct and apparent necessarily.

duction in all industries at once of labor-saving machinery will not produce unemployment, because of increased demand in the machinery industry. But for Hobson it could be that this causes an increase in saving so as to upset the savings-spending ratio.[96]

The monetary and psychological explanations of the cycle are recognized by Hobson as increasing the amplitude of the cycle once it is under way: once the condition of oversaving has created the awareness of over-production:[97]

> "So far as the money is concerned, when a depression is set in, money is usually cheap, and any employer can get credit on easier terms than usual, provided he can give security, i.e., can show that there is a probability of his selling at profitable prices the goods he could purchase by setting at work his idle plant and labour. So far as the real wages or commodities are concerned, it is manifest that, if the capital and labour which stand idle at all the different points in the processes of industry used their actual producing power, the required commodities would be produced as fast as they were needed for consumption by the wage-earners who now had money to spend in buying them."

and depression sets in:

> "Because the organizers of production have reason to believe, if they set the available productive power fully to work, they could not sell the product at a price which would cover the expenses of production."

He considers the argument that depression sets in because bankers refuse to continue to extend credit. Bankers do so because they have lost confidence. They lose confidence because they believe the items cannot be sold at a profit:[98]

[96] This is an inconsistent recognition that the supply schedule for investment funds has some elasticity, while in his general statement of underconsumption above he ruled this out by assuming the schedule completely inelastic as regards all but workers' savings. This could be reconciled by recognizing a change in elasticity through time: inelastic during the upswing, elastic during the crisis and downswing.

[97] *The Industrial System*, *op. cit.*, p. 287, 288.

[98] *Ibid.*, p. 289.

"In other words, the psychological explanation of depression is an interpretation through finance of the actual maladjustment of productive power and rate of consumption in the industrial system."

He concedes:[99]

"Sometimes the 'want of confidence' is precipitated by a dramatic collapse, which suddenly exhibits the growing rottenness of trade... So absorbing is the distinctly financial aspect of these crises which often herald a widespread depression, and so clearly traceable is the financial collapse to psychological conditions, that not only financiers but commercial men and manufacturers are often led to treat booms and depressions of trade primarily as tidal movements in the minds of men."

After the previous development, Hobson's explanation of the turning point in the depression is also in terms of the savings-spending ratio and a simple matter: saving shrinks faster than consumption until *the* ratio is restored.[100] He eschews the liquidity argument:[101]

"There is no need to suppose that excessive saving is accumulated to an indefinite extent in idle loanable capital. There is another outlet which serves to conceal the extent of the excess... [part of idle funds] may find employment in acquiring for its owners possession of properties already in existence, the possessors of which are compelled by the very pressure of a trade depression to part with them. The importance of this aspect of investment during trade depression is generally overlooked and deserves special attention."

But this merely accounts for a change of hands of the idle funds; unless there is also a new set of expectations.

[99] *Ibid.*, pp. 290f. [100] *Ibid.*, pp. 293–96. [101] *Ibid.*, pp. 291.

11. NOTE ON THE RELATION OF HOBSONIAN UNDERCONSUMPTIONISM TO THE ORTHODOX OVER-INVESTMENT THEORY OF THE CRISIS

It is sometimes argued[102] that Hobsonian underconsumptionism uses "underconsumption" to mean "over-saving". Likewise, it is argued[103] that there is a possible use of the term "over-investment" in two senses: The first use is by the over-investment, or capital-shortage, theorists to mean that the crisis stems from vertical maladjustment in the production process such that more roundabout investments cannot be completed due to a shortage of capital arising from a failure of savings to grow (first the failure of the savings of individuals to keep pace with increased investments and ultimately the failure of credit expansion by the monetary system to likewise keep pace). Thus too many investments are undertaken; hence, overinvestment.

The second use of the term "over-saving" is by the underconsumption school to mean that the crisis stems from a failure of demand a) because of too much saving which b) ultimately causes a flow of supply of consumers' goods which can only be handled by the existing incomes and money supply at lower prices. Thus too many investments are undertaken; hence, overinvestment.

Robertson has pointed out[104] that the relationship between the two approaches is more than one of equivocation. The overinvestment (capital shortage) theory if it did not first lead to crisis through inability to complete investments would ultimately lead to insufficiency of consumers' demand, not because of a fall in incomes (demand side) but because of an increase in output of consumers' goods (supply side) as the investments reached fruition.

Thus, while there is an apparent conflict between the two theories, namely, the capital-shortage group arguing that *ex-ante* investment exceeds *ex-ante* saving[105] and the underconsumptionist

[102] Gottfried Haberler, *Prosperity and Depression* (Lake Success: United Nations, 3d ed., 1946), p. 122.
[103] *Ibid.*, p. 129.
[104] "Industrial Fluctuations and the Natural Rate of Interest," *Economic Journal*, vol. 44, pp. 650–656 (1934).
[105] The term "*ex-ante*" is used in the sense of the Swedish school, *e.g.*, Gunnar Myrdal, "Der Gleichgewichtsbegriff als Instrument der Geldtheoretischen

arguing that *ex-ante* saving equals *ex-ante* investment, it is possible to reconcile the two theories into a single approach. There is no reason *ex hypothesi* why one cycle may not reach its crisis at the first difficulty (inability to complete investments undertaken because of a shortage of capital funds) while the next cycle may survive this first difficulty (due to less optimistic entrepreneurship or other institutional factors limiting the amounts of new projects) and complete its investments and proceed to crisis because of the great flow of consumers' goods once the investments are completed.

Which of the two situations holds true in any given cycle might be determined according as 1) the crisis is *preceded* by a stringency in the money market reflected by a rising interest rate, or 2) the crisis is preceded by a *decline* in the interest rate. However, this would not be a possible test, for the two approaches concern different types of goods: capital shortage sees the maladjustment in the producers' goods area: an insufficiency of demand for producers' goods due to a capital funds shortage and the underconsumptionist sees the maladjustment in the consumers' goods area: an insufficiency of demand for consumers' goods due to an excess of goods relative to consumption funds.

Yet, could not a broader analysis be supplied? The interest rate may rise because (1) of an increase in demand for loanable funds relative to existing supply, through increased marginal efficiency of capital (capital-shortage theory) or (2) of a decrease in supply of loanable funds relative to existing demand, through increased consumption though the increase in consumption is still insufficient (relative to the increased flow of consumers' goods) to prevent a fall in the price level of consumers' goods.[106]

This second possibility is not, to be sure, the Hobsonian statement, for Hobson speaks of *the* ratio of saving to spending increasing. It advances, however, the proposition that there are two ratios which must be in proper adjustment both within them-

Analyse," *Beiträge zur Geldtheorie* (Vienna: Springer, 1933) and Bertil Ohlin, "Some Notes on the Stockholm Theory of Savings and Investment," *Economic Journal*, vol. 47, pp. 53–69; 221–240 (1937).

[106] This explanation *of the crisis* is close to that of Albert Aftalion, *Les Crises Periodiques de Surproduction* (Paris: Marcel Riviere, 1913) and "The Theory of Economic Cycles Based on the Capitalistic Technique of Production," *Review of Economic Statistics*, vol. 9, pp. 165–170 (1927).

selves and with reference to each other: the ratio of demand for loanable funds and supply of loanable funds and the ratio of demand for consumers' goods and supply of consumers' goods. Because of the absence of any application of any theory of the rate of interest (through the assumption that the supply of loanable funds is interest inelastic) Hobson believes that these two ratios bear a simpler relation to each other. In a vague way, Hobson may be considered as approaching the matter through emphasizing not only the ratio of saving to spending, but also the distribution of spending among its various possible applications.[107]

12. NOTE ON RELATION OF HOBSON'S THEORY TO THE FOSTER-CATCHINGS AND DOUGLAS APPROACHES

While Hobson eschews the monetary question and dismisses it as a consequence and aftermath of the crisis brought about by maldistribution of money incomes, the approaches of Foster-Catchings[108] and of Douglas,[109] while underconsumptionist in their primary thesis that crises result from insufficient purchasing power in the hands of the consumers to clear the market of existing goods at prices sufficient to cover costs, sharply dispute the origin of the insufficient consumers' demand.

In the views of Foster-Catchings and of Douglas, the crisis is occasioned, aside from any question of distribution, by monetary flaws which result in the failure to parcel out to consumers the full money sums for purchase of the goods produced.

a. THE DOUGLAS THEORY

Under the Douglas theory, which is by far the cruder version, several propositions are advanced. First, "the only effective demand of the consumer is a few per cent of the price-value of

[107] Emil Lederer, another contemporary of Hobson, comes closer to the crux of the matter in his "Konjunktur und Krisen," in *Grundriss der Sozialökonomik*, IV Abteilung, I Teil (Tübingen: Mohr, 1925), p. 394.

[108] W. T. Foster and W. Catchings, *Money* (Boston: Houghton Mifflin, 1923) esp. Ch. xx. and *Profits* (Boston: Mifflin, 1925).

[109] C. H. Douglas, *The Control and Distribution of Production* (London: Palmer, 1922) and *The Douglas Theory, A Reply to Mr. J. A. Hobson* (London: Palmer, 1922).

commodities, and is cash-credit. The remainder of the 'home effective demand' is 'loan-credit', which is controlled by the banks, the financier, and the industrialist, in the interest of production with a financial objective, not in the interest of the ultimate consumer."[110] Douglas arrives at this conclusion by arguing that the source of the money used to purchase is important. Bank-borrowed funds applied to overhead and raw materials go back to the banks and somehow do not arrive in consumers' hands! In addition the lag between the production of consumers' goods and the earlier payments to workers on those goods causes the goods to come to market long after the funds distributed in their production have been spent!

Hobson[111] criticizes the Douglas theory briefly in these terms. It is "the habitual course of trade" that today's income is spent on yesterday's production; the lag, in itself, is no basis for underconsumption. Similarly payments for overhead and materials go through the hands of workers to buy goods and then back to the producer to repay the bank loan but the only "cost" of the loan is the interest. Hobson concedes that the *constricting* of credit by bankers might cause trade depression, but Douglas does not rest his argument on this proposition, but rather that the *continuation* of a level amount of bank credit will cause trouble.

Douglas replied to this criticism[112] that he concedes Hobson's position with regard to the maladjustment of savings and consumption but denies that this is a cause of depression and argues that it is an effect "of a defective credit system." Douglas argues that both the Hobsonian and Douglas theories "are conceivably tenable."[113] As Keynes has said[114] "the detail of his [Douglas'] diagnosis... includes much mere mystification." To the extent that Douglas' *Reply* is intelligible his point is that the profit extracted by producers leaves consumption deficient in that amount to purchase goods produced, the profit not being expended for consumption. Beyond that his attack upon Hobson's denial of the

[110] C. H. Douglas, *Economic Democracy* (New York: Harcourt, 1920), pp. 66f.
[111] *Economics of Unemployment* (London: Macmillan, 1922), Ch. viii. This chapter has been omitted in the 1931 edition.
[112] *The Douglas Theory, a Reply to Mr. J. A. Hobson, op. cit.*, p. 3.
[113] *Ibid.*, p. 4.
[114] *General Theory of Employment, Interest and Money, op. cit.*, p. 371.

causal role of bank credit is a valid reply to Hobson's criticism, even though it is no defense of Douglas' position.

b. THE FOSTER-CATCHINGS THEORY

Foster-Catchings criticize the Hobsonian theory[115] as well as the Douglas theory as artificially distinguishing between consumption and production through failure to recognize that expenditures for capital goods return to the economic stream through consumer expenditures. This criticism is correct as applied to the Douglas theory. But in the attack on Hobson, Foster-Catchings fall short in insisting that the Hobsonian analysis be read in terms of the initial stage only: the increase in savings resulting in less money for *immediate* consumption (and hence crisis) whereas Hobson's thesis concerns the situation *after* the flow of consumers' goods has begun from the new investment.

Attacking the Hobsonian theory through evidence of wartime expenditures on ships and munitions (classed by Foster-Catchings as *increased* investment with no underconsumption following) is not invalidating but rather *corroboration.* Hobson himself uses this illustration in his theory of imperialism to show the dissipation of surplus in a way which does not increase the volume of consumers' goods. It is quite apparent that Foster-Catchings are not familiar with the theory of imperialism.

The other Foster-Catchings criticism[116] of the Hobsonian analysis is that it fails to incorporate liquidity, loan repayment and monetary phenomena. This criticism is made in only one sentence.

Foster and Catchings' theory strikes at profits as the unbalancing factor of the economy. Insufficient purchasing power is distributed in production for the repurchase of goods at cost *plus a profit*, which is collected *before* it is spent, and hence the only possible adjustment is a falling of prices—a price-level adjustment—to reestablish equilibrium between consumers' incomes and the prices of goods. The only other possible adjustments would be through increase in the volume of currency and credit, or, theoretically, through increased velocity. Thus the essence of the Foster-Catchings theory concerns the situation

[115] *Money, op. cit.*, pp. 339–46.
[116] *Money, op. cit.*, p. 343.

when there is an increase[117] in production. At first, the flow of money precedes the flow of commodities (causing price rises and further widening the profit margin) but later the effort to collect the profit causes insufficient purchasing power when profits are not spent but accumulate in idle balances.[118] Foster-Catchings specifically deny that a faster increase in profits than in wages or an increase in rate of investment prevents sufficient funds getting to consumers. But they show that they do not literally mean those statements. In placing the full emphasis on a money shortage at the crisis, they argue that an increase in the *rate* of investment could continue indefinitely if money supply expanded sufficiently! Thus they are not arguing that there could be an increase indefinitely in the *rate* of investment in *real* terms. But money supply, they argue, is limited by bank reserve requirements and not by rates of profit or investment.

In short, for Foster-Catchings:[119] "...this treatment of redistribution of incomes, advocated by Hobson cannot remedy the malady of the cycle; it can merely check its development; for a maldistribution of income is only one of the conditions, not the primary cause of the malady."

It is submitted that there is no necessary conflict between the Foster-Catchings and the Hobsonian theories except in so far as each claims to have the *sole* causal factor. The monetary element and the real element in underconsumption may conceivably exist side by side. Both Hobson and Foster-Catchings lack any developed theory of interest rate adjustments.

Foster-Catchings fail to see that an increase in the flow of investible funds due to a rise in profits, involving a rise and redistribution of income, may have the same effect as an increase in investible funds due to a rise in the rate of voluntary savings involving no change in the size and distribution of income.[120]

This is not to infer, however, that there are only two versions

[117] Though at several places (*e.g.*, *Money*, *op. cit.*, p. 348) Foster-Catchings state that increase in production is not the necessary starting point in their analysis, they always do start with this condition!

[118] *Money*, *op. cit.*, pp. 346–51.

[119] *Profits*, *op. cit.*, p. 356.

[120] The logical identity is also missed by another underconsumptionist, Erich Preiser, *Grundzüge der Konjunkturtheorie* (Tübingen: Mohr, 1933) *passim*, where he claims (pp. 80–84) that only the profits path to investible funds' increase can lead to collapse.

of "underconsumption" theory. Integration with over-investment theory is possible. For example, the boom may collapse because the supply of capital becomes short as in Robertson's analysis, due to the adoption of more roundabout means of production when there is an unusually low interest rate. Or the boom may collapse because consumers' demand is unable to dispose of increased productive capacity; the approach of Hobson and Foster-Catchings. Both these approaches can be termed, in a sense, over-investment relative to money flow: one at the top of the structure of production in the later stages and the other at the bottom in the earlier stages. However, it is, for example, conceivable for an underconsumptionist to follow Robertson's approach which would lead ultimately to the underconsumptionist result of insufficiency of consumers' demand.[121]

[121] D.H.Robertson, "Industrial Fluctuations and the Natural Rate of Interest," *Economic Journal*, vol. 44, pp. 650–56 (1934). The detail of the above argument is contained in the preceding Note on "The Relation of Hobsonian Underconsumptionism to Orthodox Over-Investment Theory of the Crisis."

CHAPTER VII

TAXATION AND EXPENDITURE POLICY

1. THEORY OF TAXATION

a. GENERAL STATEMENT

Hobson recognizes taxation and public expenditures together with wage policy as the prime remedies of the cycle.[1] His theory of taxation rests heavily on two general propositions of his system of economics: the surplus concept, and the theory of underconsumption. For him, these are not two separate propositions. The first, logically, is the surplus concept. With Hobson, as was seen in Chapter V, surplus is that part of income or remuneration of any factor of production in excess of what is necessary to draw that factor into production, or as Hobson says:[2] surplus is the excess over what is "physically and morally necessary to secure the continued use of the factor of production whose owner receives it." It may be objected that:[3]

> "...we possess no means of discovering exactly where 'costs' end and 'surplus' begins, and that our distinction is a 'theoretical' one not suitable for fiscal application. This objection applies to all distinctions... It does not mean that the distinction is for practical purposes invalid."

Although the distinction is difficult to make in practice, Hobson is quite clear as to what is meant. He considers the traditional income groups in turn and points out what is surplus with respect to each.

In the case of wages, "the standard wage in any trade or locality is a necessary 'cost' of production, in that, if it is not paid, the

[1] *Economics of Unemployment* (New York: Macmillan, 1922, rev. ed. 1931), p. 73.
[2] *Taxation in the New State* (New York: Harcourt, Brace, 1920), p. 14.
[3] *Ibid.*, p. 26.

requisite supply of labor is not forthcoming."[4] He concedes that the amount so determined contains not only what is physiologically necessary but also elements dictated by "conventional expenditure." But wages as a whole are "virtually irreducible." This does not, however, consider the effect that recent development of unionization may have.

Similarly interest contains a cost element—that "payment for the production and use of capital that must be secured to the owners of this capital to induce them to go on supplying it in the required quantities."[5]

Although "profit is notoriously a slippery term," it too has an element economically necessary to draw entrepreneurship forth and the balance is surplus. Hobson calls profit the true "residuary legatee" of income distribution.[6]

In the case of commercial rent, part of the "rent" may be a true cost. Part of the rent is a differential covering superiority over marginal land; but even the worst land in its worst use may yield a positive rent because of scarcity. This part of rent cannot be explained as differential. Only the latter part is surplus. That part of rent which is the recovery of improvements and interest thereon is not surplus but a cost.

b. USE OF SURPLUS CONCEPT IN TAXATION

Surplus forms the basis for the Hobsonian principle of taxation. Taxes *can* only be *economically* levied where there is ability to pay, and Hobson argues that ability to pay exists only where there is surplus. Surplus is also the source of savings. Maldistribution of the surplus over the economy causes those who receive excessive portions of the surplus to drive the quantity of savings above the amount appropriate to the current volume of consumption and thus causes the trade cycle. Similarly, the pressure of this accumulated and excessive saving causes the *problem* of imperialism described in Chapter IV above.

With this brief statement of what use is to be made of the concept of surplus in the Hobsonian tax system, we can return to analysis of the concept of surplus for tax purposes. Hobson at-

[4] *Ibid.*, p. 16. The concept of surplus is more fully considered in Chapter V above. It is here summarized so far as useful to a consideration of Hobson's theory of taxation.

[5] *Ibid.*, p. 18. [6] *Ibid.*, p. 23.

tempts to distinguish his concept of surplus (non-necessary cost) from the idea of reservation price, and hence his concept of surplus from economic rent and quasi-rent. He phrases this distinction in terms[7] of an objection to the neo-classical emphasis upon consumption (demand) and consideration only in that connection of utility and the ignoring of the disutility in production (supply). Actually the Hobsonian objection is rather to inequality of bargaining power between labor and capital both in the productive process and the consumptive process, giving rise to "surplus" in the hands of the rich monopolist. And Hobson finally recognized that this was his position.[8]

In *Economics of Distribution*,[9] the summation of the theory of surplus value is "In other words, differential rents do not constitute such a surplus." The term "marginal rents" covers the "forced gains" arising from unequal bargaining power.

But he fails to adhere to this on an operational basis and Hobsonian surplus becomes nothing but the gap between a reservation price and a market price. There is this difference: reservation price because of holding for future markets, can exceed what Hobson would recognize as "cost." On the other hand, inclusion within "cost" of such elements in the case of wages, as "conventional expenditures and even including some elements of comfort or luxury, not always conducive but perhaps even detrimental to working efficiency,"[10] may raise Hobson's "cost" above reservation price in some cases.

Despite these difficulties, Hobson's intent is clearly that surplus is "the result of 'monopoly' or superior economic opportunity."[11] This must be related to the fact that Hobson himself considered[12] his most important contribution to economics to be the "discovery" of the twofold truth: that many markets are so restricted as to give sellers as a group superior bargaining power over buyers, recognizing exceptions such as the labor market raise,

[7] "Neo-classical Economics in Britain," *Political Science Quarterly*, vol. 40, pp. 337–383 (1925).
[8] *Confessions of an Economic Heretic* (London: Allen, 1938), p. 19.
[9] New York: Macmillan, 1900, p. 352.
[10] *Taxation in the New State*, *op. cit.*, p. 16.
[11] *Ibid.*, p. 32, 73. In short, a supply curve which becomes more inelastic beyond a given point.
[12] *Confessions of an Economic Heretic*, *op. cit.*, p. 19. Cf. discussion of this *supra* Ch. II and Ch. V.

and that even where free-bargaining obtains, the determination of market price which leaves the marginal pairs also leaves other buyers and sellers with surpluses.

c. SURPLUS AND ABILITY TO PAY AS THE BASIS OF A UNIFIED THEORY OF TAXATION

Whatever the practical difficulties, which Hobson admits, in "discovering exactly where 'costs' end and 'surplus' begins,"[13] this does not invalidate the concept of surplus for practical purposes as Hobson proceeds to demonstrate. He has at once a single principle which unifies the problems of equity, incidence, economy and incentive. Briefly stated, the application to each of these is as follows:

1. As applied to economy, taxation of surplus places the tax burden where it will not interfere with output (the concern of every minister of finance that the source being taxed will not dry up[14]), leaving untouched the true amount necessary to the continuation of that factor in production.

2. As applied to incidence, Hobson argues that all taxes wherever levied will settle on the nearest surplus by forward or backward shifting.[15] A tax cannot *ultimately* come to rest elsewhere than on a surplus since *by definition*, if it rested on a "cost," the factor would be withdrawn. The tax will tend to rest on the nearest surplus since it will be moved from that surplus only if its owner realizes that he has superior bargaining power over another nearby surplus owner. Hobson immediately meets the objection that if this is so, it is a matter of indifference where the tax is *levied* by the threefold answer: (1) that the process of shifting involves waste and damage, because in the short run (a) there will be a shrinkage of output or (b) an encroachment on the "cost" of the factor until (c) the shifting process is complete, and (2) that there is assumed "a certain level of intelligent self-interest which does not exist everywhere" and this enhances the possibility of temporary and damaging encroachment on the "cost" of a factor, and (3) it is essential to popular self government that public finance be "open and intelligible to the citizens."[16]

[13] *Taxation in the New State, op. cit.*, p. 26. [14] *Ibid.* [15] *Ibid.*, p. 63.
[16] *Ibid.*, p. 66.

3. As applied to equity, the taxation of surplus follows directly ability to pay, the recognized canon of equity.

4. As applied to incentive, Hobson must meet the objection that he is assuming a static condition and that by taxation of surplus "you will make economic progress impossible."[17] Hobson's answer is that (1) his definition of 'costs' includes "not only such a minimum interest and profit as are needed to maintain existing plant and business ability, but such as would evoke an increasing supply of these factors so as to provide for a progressive industry,"[18] (2) "To divert surplus-income which might, if left in private hands, have furnished an increase of private industrial capital, into these State employments, involves no net reduction in capital or employment of labour," and (3) even if taxation of surplus did involve reduction in rate of creation of new industrial capital that would be no condemnation since labor and ability are more important than capital and can be cheaply purchased by some diminution of capital.[19]

d. CONSUMER CANNOT BEAR A TAX

Hobson strives to show that the consumer *does not* bear any taxes. In establishing this proposition he lumps together what is today technically known as incidence with what is technically known as tax effects (respectively the price and output effects of taxation). Whether the consumer can bear a tax is of vital importance in the Hobsonian system because possible impairment of consumption would be a prime objection by an underconsumptionist to any tax policy.

A monopolist, he recognizes,[20] fixes his prices so as to get maximum profits. This he argues will be the same price and output as after a tax in the case of an income tax, but it is not true of a fixed unit tax. Whether it is true of an ad valorem tax depends upon whether the tax varies in proportion to the profit at different outputs. In a footnote Hobson says:[21]

> "There are rare cases where the imposition of a tax might cause a monopolist to raise selling prices, but there are as many where it might cause him to lower them."

[17] *Ibid.*, p. 68. [18] *Ibid.*, p. 69. [19] *Ibid.*, p. 71.
[20] *Ibid.*, p. 39 and *Economics of Distribution, op. cit.*, p. 316. [21] *Ibid.*

This is by way of qualification after a literal application of the proposition that the consumer can bear no tax.

Where he is more careful, Hobson brings out[22] what he means by the proposition that the consumer can bear no tax:

> "Indeed, from the standpoint of real taxation, there is no such person as the consumer. All taxation falls upon some element of income, and the consumer is not, as such, a recipient of income."

and:[23]

> "We are entitled to dismiss altogether the consideration of the consumer in dealing with the theory of distribution, *provided that we deal with real payments for the use of factors of production.*" [Italics mine—E.E.N.].

It should now be clear that Hobson's proposition that the consumer cannot bear a tax is a matter of point of view. Hobson prefers to consider each individual from the point of view of his real income, i.e., what happens to him as a consumer-purchaser is immediately translated to him as an income recipient, as affecting his real income. Thus he attempts to classify all *changes* in consumers' surplus into producers' surplus changes.

[22] *Ibid.*, p. 50. In *Economics of Distribution, op. cit.*, p. 298: "The theory of the incidence of taxation suffers from this same confusion [of orthodox economics]. It is often urged that a tax laid upon some product or some factor of production will be shifted on to the consumer through a rise in prices. But this, though often true, is no ultimate analysis. For it will be admitted that consumers can in some cases throw back the tax upon some body of producers. The only consumers who must be deemed taxable, *qua* consumers, are those in receipt of a guaranteed money income; those whose income is derived from and fluctuates with the value of some factor of production will be liable to have their income affected by a tax which is imposed upon them in an enchanced price of commodities. It would be necessary to investigate the source of income of each consumer closely in order to ascertain how far he ultimately bore the tax which raised the price of the commodities he consumed. The ability to throw back a tax upon producers and the rapidity of such rejection are matters for detailed practical inquiry. But in a theory of taxation every part of a tax must in its ultimate incidence be traced to some class of producers, if we are to understand its effect upon the distribution of wealth."

It is apparent that Hobson's proposition that the consumer can bear no tax is to be understood in a very limited sense.

[23] *Economics of Distribution, op. cit.*, p. 299. But even here Hobson passes over the possible price effect of taxes in his anxiety to show the importance of incidence.

However, Hobson is guilty of equivocation by forgetting himself, here and there, and applying a literal interpretation of his statement that the consumer bears no tax. Thus he argues that where price is raised after a tax levy, there "will often be a shrinkage in consumers' purchases,"[24] which throws the tax on the producer. But only part of the tax is so shifted—that part determined by the relative elasticities of the demand and supply curves, as he elsewhere recognizes.[25] Hobson even struggles with the case of a highly inelastic demand—and claims the tax is not borne by the consumer because of the substitution that may follow.[26]

From his theory of surplus Hobson claims to have exploded "two fallacious notions; that taxes are paid by the poorer classes of the working population, and that high taxation is injurious to trade."[27]

His argument against taxes on liquor and tobacco is a logical development of his principle that the consumer can bear no tax.[28] His objection rests on the ground that a tax levied where it will not rest causes economic damage in the shifting process. The heavy taxes on liquor and tobacco are in part transferred to "employers and other owners of a surplus" through demands for higher wages.[29] He argues this despite admitting that "a considerably larger sum" is expended on liquor and tobacco as wage incomes increase. Hobson recognizes the regressivity of these "indirect" taxes and then[30] undermines his argument that consumers bear no taxes by admitting "It is evident that in one sense these taxes may be held to fall upon a 'surplus', in another sense not."

The only valid argument for liquor and tobacco taxes, Hobson argues, is that a reduction in their consumption may follow the tax. Similarly, he objects to any argument seeking to justify liquor and tobacco taxes on the ground that every citizen ought to pay taxes and thus realize the responsibilities of citizenship. This argument, he says, rests on a fallacious concept of State revenue.[31] The State in taxation merely claims *society's earnings*

[24] *Taxation in the New State, op. cit.*, p. 58.
[25] *Economics of Distribution, op. cit.*, p. 316.
[26] *Taxation in the New State, op. cit.*, p. 55.
[27] *Economics of Distribution, op. cit.*, p. 334.
[28] *Taxation in the New State, op. cit.*, p. 60f.
[29] *Ibid.*, p. 61. [30] *Ibid.* [31] *Ibid.*, p. 104.

(monopoly income—surplus) and does not and should not entail *sacrifices* by any one.

2. TAX POLICY

a. THE INCOME TAX

It is implied in the Hobsonian analysis so far that the income tax and death tax are the only economically correct taxes,[32] since they reach surplus and cannot be shifted, cannot impair incentive and are equitably proportional through graduated rates. At least this is so when the rates are not so high as to dig into the "cost" element of "income".

There are possible objections to an income tax, and Hobson considers these separately. The first is the problem of former owners who have sold to present owners on the basis of capitalized surplus earnings. Taxing the new owners on the current earnings would not be reaching surplus but "cost" for the most part, and former owners would bear only a small fraction of the tax on surplus, namely, on the present income from such capitalized surplus. To this problem, Hobson offers two solutions:[33] (1) capital gains tax (which the British have in large part never used) to capture the future gains, and (2) estate or death duties to deal with the past. On their relative merits, Hobson favors[34] the death duties for fear of interference with incentive involved in the complexities of a capital gains tax. This is contradictory unless it is arbitrarily accepted that a capital gain is not income, since he previously denied an income tax effect on incentive. How a capital gains tax would solve the problem is an interesting question as it is now in the United States: possibly involving interpolation by the seller into his price of part of the tax to be due.

On the practical level, Hobson argues for the following propositions with regard to the income tax:[35]

[32] The single tax, or land tax, is rejected as inequitable (1) since it reaches only one area of surplus and (2) since it does injustice between land-owners by discrimination at the time of its adoption (a) in favor of those who sold landholdings and realized the surplus which would then be free of tax, and (b) against those who bought landholdings at a price capitalizing the surplus in reliance upon no change in the tax system. *Ibid.*, p. 81. The second objection Hobson recognizes as inherent in any tax change, even of income tax rates. *Ibid.*, p. 82.

[33] *Ibid.*, p. 83. [34] *Ibid.*, p. 116. [35] *Ibid.*, pp. 84–110.

1. The increasing reliance of government on the income tax "strongly recommends" its equity, incidence, economy and incentive principles.

2. First attention should be given to size of income and second attention to the number of persons dependent on it, since it can be presumed that the amount of surplus in an income varies directly with the size of the income and inversely with size of family. This leads directly to aggregating family income for a Family Income Tax based on a division of Family Income by the number of dependents and the taxation separately of each column of income. This is to be applied, however, only as regards the first £ 2,500 of income as of 1920 prices.

3. Hobson opposes any further distinctions, such as earned and unearned income as "clumsy and wasteful." This conforms to his theory. To classify *all* interest as unearned and *all salaries* as earned ignores the surplus concept. The true part of this argument is covered by the Family Income Plan and a *limit* on the earned income allowance recognizes the defect of the argument.

4. The curve of tax rates should increase at an increasing rate (the then current British tax increased at a decreasing rate) to avoid early degressivity.

5. No exemption of such institutions as life insurance companies. Such a provision, among other things, stimulates attempts to save by the poor who should not be saving. This implies two contradictions: (1) if tax exemption stimulates then conversely the income tax must affect incentive, and (2) if the poor can over-save, then maldistribution of income is not the sole cause of the cycle. Hobson opposes preference for any one group, such as farmers, which appears particularly with super or excess profits taxes.

6. The argument that all ought to pay a tax, however small, as an acknowledgement of citizenship, is rejected as regards the income tax on the same basis used for liquor and tobacco taxes, that this is a misconception of the nature of State revenue which should be social earnings, and not sacrificial payments.

7. Provision should be made for automatic adjustment of exemptions to price level movements.

8. Collection at the source as a policy is administratively in conflict with the theory of progressivity on the ground that collec-

tion at the source would be too involved if it recognized dependents, etc. Other means of checking evasion, e.g., through reporting by the payor, are as effective. The excuse of collection at the source is used as an argument against progressivity by administrators.

9. At certain periods (e.g., post-World War I Britain) a deduction from income tax of a percentage of saving for those in the bracket between Family Income and super-tax is recommended since saving by this group is at a sacrifice.[36] Theoretically Hobson would not allow this deduction to the low income group since it has no warrant to save. This deduction would merely delay the collection of the tax until death duties are paid and enable the State to direct investment to particular channels as required by given circumstances.

10. There is a theoretical possibility[37] that the income tax rate on high incomes can be too high causing (1) loss of saving (since saving would react quicker than spending) and (2) loss of incentive to earn, although the exact opposite may be the reaction in earlier stages of high rates.

b. DEATH DUTIES

Hobson considers death duties[38] as both complementary and substitutional with reference to the income tax. Through death duties (1) evaded income taxes, (2) unrealized gains, and (3) fortunes antedating the income tax or its present high rates are reached, and these are forms of surplus "peculiarly fitted for taxation." In addition, death duties conform closely to the theory of underconsumption as an economic way of reducing the tendency towards the accumulation of excessive savings. As such, death duties have a damping effect on the trade cycle.

The chief function of the death duty is, however, complementary, not substitutional, to the income tax: to prevent too high an income tax rate and yet to be sure to catch the results of too low an income tax rate.

Curiously, the gift tax is ignored. Conceivably an underconsumptionist could go either way on gift taxes. The absence of a

[36] *Ibid.*, p. 113. [37] *Ibid.*, p. 115.
[38] *Ibid.*, pp. 110–118, without considering an inheritance tax separately from an estate tax.

gift tax in the presence of an inheritance tax encourages consumption and equalization of incomes provided that gifts *mortis causa* and spendthrift trusts are eliminated. Contrarywise, a gift tax at a lower rate than an inheritance tax might achieve these gains and the more immediate dissolution of the savings fund.

c. SUPPLEMENTARY TAXES

Hobson would admit[39] some taxes supplementary to the income tax based (1) on special tests of ability to pay, or (2) on welfare considerations other than fiscal, where morals, health or public order are involved. The principal objection he raises to the present handling of these taxes is their regressivity when relatively simple steps could considerably reduce this regressivity.

d. TARIFF FOR REVENUE

Fundamentally, an underconsumptionist must be opposed to a tariff whether for protection or revenue on the ground that both types of tariff reduce production and consumption and both are slow in being shifted by consumers, the same logic used to oppose indirect taxation generally.

However, in his first work, *The Physiology of Industry*, Hobson points out[40] that the free trade argument rests on the assumption that what can be produced will be consumed. He does not again challenge the free trade argument until 1922[41] when an exception in favor of protection in the case of world-wide unemployment is recognized.

In the case of the tariff for revenue,[42] however, there are particular situations which may lead to apparent exceptions. The first case is dumping. Can a British import tariff get at the surplus accruing to an American or German exporter engaged in dumping? Hobson says no, arguing that any true surplus arises from the sales by the dumper in his own country—that it is not a case of reaching the surplus of the dumped sales but of trying to reach the surplus arising in another country from sales in that country. Hobson considers two possible contrary arguments: (1) that the tariff on dumped goods may lead the dumper to sell elsewhere (at

[39] *Ibid.*, pp. 118–127. [40] London: Murray, 1889 at pp. 206–209.
[41] In *Economics of Unemployment, op. cit.*, Appendix.
[42] *Taxation in the New State, op. cit.*, pp. 127–144.

home or abroad) or to cut back production and thus permit the British producer to raise his price or to come into production, (2) that the tariff on dumped goods may still leave a more profitable margin to the dumper selling in Britain than selling elsewhere. "But this will hardly ever be the case."[43]

This second case will involve either or usually both of these conditions: (a) a large economy of production costs arising from volume alone, and (b) a system of taxation in the dumper's country such that it does not reach the dumper's surplus. But neither of these conditions is likely to exist where raw materials are a large part of costs, Hobson argues, because differential rents will cause the withdrawal of marginal sources.

This analysis is entirely from the supply side and ignores the elasticity of demand for the product involved—both in the dumper's country and in the importing country. Hobson indicates that he abstracts from the possibility of tapping the surplus of the British importer[44] who has an inelastic demand in Britain because (a) this surplus has already been reached by British tax, or (b) is vulnerable to British production of this good. This is not entirely valid because Hobson has not established a correlation between elasticity of demand for the product in Britain and progressivity of the income tax rate in Britain.

Hobson is prepared to dismiss further discussion of the tariff with the claim that it is "notoriously a clumsy instrument" with incalculable shiftings, delays and incidental injustice of incidence, uncertainty in yield, costliness in collection and the breeding ground for political corruption. In addition it adds to monopoly profits of the protected British producer. But, is this to be considered as evading British income tax?

To this discussion of tariff for revenue, Hobson adds the argument against tariff for protection that such a tariff reduces the nation's real income (and thus its taxable surplus) by depriving a nation of its most profitable productivity,[45] through affecting its comparative advantage.

The final arguments used are (1) that of those possibly defen-

[43] *Ibid.*, p. 131. [44] *Ibid.*, p. 136.

[45] This argument is developed at length in John A. Hobson, *The New Protectionism* (New York: G. P. Putnam's Sons, 1916) and considered in Ch. IV *supra*.

sible tariffs (e.g., non-food) the yield is very small in proportion to the post-war budget requirements and (2) that the Imperial preference applies only to a small part of the volume of imports.

e. CAPITAL LEVY

After carefully looking at Britain's post-World War I situation[46] and finding that the dimensions of the problem were so large as to be beyond any *income* sources, Hobson launches into the capital levy, considering first a levy on "war-made wealth"[47] and then a "general levy on capital."[48]

British government debt in 1920 totalled about £7,000 millions. Hobson estimates the net increase in wealth in Britain during World War I at £6,000 or 7,000 millions[49] after allowing for liquidation of foreign investments and for foreign holdings of British debt. He traces a few of the sources of this increase in wealth:

1. About £300 millions from sunk ships which were paid for by the government at war prices for ships, the owners thus recouping a price increase via a tax-free liquidation and capital gain.
2. Unestimated increase in banks' net worth from credit creation and high interest rates with most of the profits kept out of income by excessive depreciation of securities under asset valuation policies.
3. Brewery properties' increase of £200 millions from 1913 through 1917 alone.
4. Landowners' increases. Unable to raise rents under war-time rent control, landlords avoided this rule by selling properties to tenants at inflated figures, the tenants getting the funds from war-time food profits and the British income tax rule that assessed farm incomes at 1/3 until 1915, and thereafter permitted easy evasion.
5. Accelerated depreciation allowances.

[46] *Taxation in the New State*, *op*, *cit*., pp. 145–165.
[47] *Ibid*., pp. 165–189. [48] *Ibid*., pp. 189–228.
[49] Corroborated by Josiah Stamp, "An Estimate of the Capital Wealth of the United Kingdom in Private Hands," *Economic Journal*, vol. 28, pp. 157–66 (1918) at £5,250 millions but this is after deducting capital losses which would not be deducted in the case of a levy on war wealth as opposed to the general capital levy being considered by Stamp.

6. The use of stock dividends which enable cash to be realized without tax.
7. Profits on war surplus sold back at below market prices.

In a proposed levy on war-made wealth, no deduction would be made for falls in value such as would be made in a general capital levy.

The direct cause of this swollen increase in wealth Hobson finds in the failure to finance the war by taxation instead of debt.[50] Failure to hold demand down by taxes led to much of the excess profits.

The primary difficulty with a levy on war-made wealth is that:[51]

> "it might be impossible to reach any measured differentiation between the enlargements of capital that came from 'war-profiteering' in the vicious sense and those which represented the play of the normal forces of increase in profits and investments."

unless the simple assumption is made:[52]

> "that war-profiteering in the vicious sense varied directly with the proportion of the increase in capital values."

The specific program Hobson was considering for a general capital levy was 20%: collecting £3,500 millions, or half of the British debt in 1920, from an estimated[53] total capital of £16,000 millions. Numerous objections to such a levy are considered:

1. That a capital levy would be a *pro tanto* repudiation of debt to war loan holders. This can be no objection if *all* capital is taxed at the same rate. The small holder would be exempt; the large holder merely has surplus which should have been taken in war taxation.

2. That seizure of the capital gives no advantage over seizure of the income from that capital over the years, and in fact presents the problem of the State assuming ownership of 1/5 of a vast miscellany of assets. On the contrary, Hobson argues, immediate

[50] *Taxation in the New State, op. cit.*, p. 183.
[51] *Ibid.*, p. 185. [52] *Ibid.*, p. 186.
[53] Josiah Stamp in "An Estimate of Capital Wealth, etc.," *Economic Journal, supra.*

seizure solves the then current problem of a 5% rate on the debt (a rate 75% higher than the pre-war rate on the debt). Such a high rate has four distorting effects. First, it depreciates pre-war bonds. Second, it makes new debt difficult to raise and Britain then had a disproportionately large part of the debt in Treasury bills. Third, it results in increased foreign holdings of British debt (which could be recalled by proceeds of the levy) and liquidation of Britains's foreign holdings. This liquidation causes an annual reduction of £150 millions in interest flowing to Britain which must be balanced either by decreased imports or increased exports; import reduction would dangerously affect production since imports are of raw materials, and export increase in competition with other countries not saddled with the high post-war British costs would be very dubious. Fourth, it involves dangerous consequences if deflation set in and reshuffled national income distribution.

3. That the capital levy would reach only "material capital" and not "personal capital". Pigou is so disturbed by this discrimination as to require an extra income-tax (as an adjunct of the capital levy) on professional incomes. Hobson does not follow such thinking. Since this type of asset is nontransferable, its capitalized value of necessity is much lower than material wealth producing equal income, and the danger to incentive is greatest in this area.

4. That a capital levy discriminates against the thrifty and in favor of the spendthrift. To this Hobson answers:[54] "But what would you do? You cannot tax income which does not exist" and earlier[55] "Public revenue must be collected where it can without too much difficulty be got." But more to the point, Hobson objects 1) most of the wealth reached by the capital levy will be that which did not arise from thrift but from inability to spend all income, and 2) damage to thrift cannot follow from a *single* such levy where no fear is induced of repetition.

5. That, while "the direct effect of a levy on the quantity of present capital available for financing new enterprise is nil,"[56] and if the rich hold war loans in proportion to their wealth, distribution is unaffected, yet there is the possibility that bank credit will contract because of the loss of assets to private holders *unless*

[54] *Taxation in the New State, op. cit.*, p. 209. [55] *Ibid.*, p. 208. [56] *Ibid.*, p. 211.

the State enlarges its credit in place of the contracted bank credit.[57]

6. That the levy would be impracticable of administration. Under this heading, many problems are considered:

(a) the lack of a monetary measure—but Pigou's analysis of estates shows 70% of property in "monetary" form (stocks, bonds, cash, deposits, mortgages, insurance) and an additional 16% (mostly real estate) already assessed.

(b) evasion is no more involved than in any other tax—and the death duty would catch the evaders. The popular notion of conversion to diamonds, etc. would have little possibility because the price of diamonds would rise in *proportion* to the tax and *after* the levy would fall back! Bearer bonds similarly are already written up for their income tax evasion possibilities.

(c) one practical program[58] is for the Treasury to publish a stock list allowing stockholders slightly more than market price and permitting war loan holders to accept these at a rate slightly under market price—a self-executing system of capital levy *and* debt retirement.

(d) in some rare and hardship cases, installment liquidation might be allowed if the Government did not want to take the asset in kind.[59] This is no concession of principle since the object of the levy is to pay off as much of the debt as economically as may be feasible and as soon as possible.

Hobson is himself undecided as to which of the two levies (war-wealth or general) is preferable.[60]

Early in the development of his theory[61] Hobson had argued that the *incidence* of all taxes, even capital levies, is *income.* He had also argued[62] that tax sources after World War I had risen but not as much as price levels; but he gives *no* supporting data for this statement. There may be several explanations, not mutually exclusive: (1) a levelling redistribution of incomes could be the reconciling factor; in Hobsonian terms this means less surplus, (2) loss of real wealth involved in war: less surplus, (3) bank credit expansion: reshuffling of asset ownership with the rich

[57] *Ibid.*, p. 213.
[58] Sydney Arnold, "A Capital Levy: The Problem of Realization and Valuation," *Economic Journal*, vol. 28, pp. 276–86 (1918).
[59] *Taxation in the New State, op. cit.*, p. 223.
[60] *Ibid.*, p. 224. [61] *Ibid.*, p. 10. [62] *Ibid.*, p. 6.

holding safer investments with a lower (absolute) rate of capitalization, but a higher rate relative to safety, after the war by comparison to pre-war, and (4) export-import and foreign investment losses by Britain

It is easy to see that one's choice of explanations and emphasis is decisive of much of the question of capital levy vs. income tax—and should particularly be so under the Hobsonian analysis.

f. LOCAL TAXATION

Hobson insists that the surplus concept and theory of taxation be carried over into the field of local taxation,[63] but, although he does not admit it, this is the most difficult area for its application.

The most readily available tool for Hobsonian theory is the Grant-in-Aid which he favors not only (1) to avoid indirect taxation, but (2) because local expenditures require the policing for minimum standards and efficiency that go with Grants-in-Aid, and (3) because of equalization between the poorer and richer districts. Where local services (*e.g.*, utility services) involve a direct *quid pro quo*, the charge should be limited to cost or the local tax will destroy the principle of taxing surplus by making the profits on such taxed operations discharge part of the remaining tax burden which should fall entirely on a surplus.

In particular, Hobson opposes the real property tax on the local level as on the national level.[64] While it might seem that Hobson should favor the single tax argument since the real property tax reaches one of the Hobsonian surpluses, he objects 1) because the realty tax produces discrimination between land and surpluses accruing to other factors, and 2) though all taxes are shifted to the nearest surplus, tax shifting produces discrimination. He adds as objections the difficulties raised (1) by leases (the lessee getting the benefits during the term but the lessor paying the taxes) but Hobson forgets that a tax clause in a lease could solve this in part, and (2) by suburban development. But (1) local benefits so largely flow to land that some special contribution is justified from this source and (2) such a land tax should be so designed as to stimulate the most productive use of the land.

A local income tax is opposed[65] as too easy to evade by changing

[63] *Ibid.*, pp. 228–253. [64] Cf. *supra*, n. 32.
[65] *Taxation in the New State*, *op. cit.*, p. 247.

residence. Instead a tax based on annual rental value of occupied buildings is "the best available index"[66] of surplus, provided it is graduated and with recognition of number of dependents. The objection that this discriminates against those who prefer to spend on housing as compared to other luxuries is met with the argument that this economizes housing and tends to reduce rents to the poor.

3. DEFICIT FINANCE AND EXPENDITURE POLICY

Hobson does not recognize the possibility of using deficit finance as a tool for income redistribution or reduction of oversaving. Rather he would use direct taxation and expenditures and wage policy for this purpose, but only within the confines of a balanced budget.

In *An Economic Interpretation of Investment*[67] he speaks of "state loans" by which he means loans "permanent and fructifying" such as "railroads, harbours, land reclamation, water works, etc." These he approves. He opposes "Government loans," calling them "so vague and attenuated that they cannot rank seriously in our account of the 'economic work' of investments. Such loans have in effect been the great despoilers of industry, and, by the temptations they present to certain classes of the saving public, the great retarders of industrial development."[68]

This is surprising in one respect in that Hobson thoroughly understood the role of finance as the governor of the policy of imperialism,[69] although he later saw in international finance a possible tool for peace.[70] It is not surprising due to failure to recognize liquidity preference and the refusal to recognize the role of the rate of interest as important.[71]

Though Hobson considers expenditure policy as equal in importance to tax policy, there is much less development of it:[72]

[66] *Ibid.*, p. 248. [67] London: Financial Review of Reviews, 1911.
[68] *Ibid.*, p. 23.
[69] *Imperialism* (London: Allen, 1902, 1905, rev. ed., 1938).
[70] *An Economic Interpretation of Investment*, *op. cit.*, p. 116f.
[71] *Imperialism*, *op. cit.*, p. vi.
[72] *Rationalisation and Unemployment* (London: Allen, 1930), p. 95.

> "So far as these [social] services are supported, in whole or in part, by rates or taxes, they must be reckoned as additions to the real income of the workers (due allowance being made for taxation borne by workers), an equalization tendency in distribution of income."

Hobson includes as aiding factors, any public expenditures even though not primarily for the poor where the tax burden is on the rich out of proportion to their participation in benefits. Noting the increasing tendency towards "income tax, super-tax and inheritance duties" which "taxation, as also the high rating for local services, though it may sometimes be shown to increase costs of production in manufacturing and other businesses, tends to expand the total expenditures upon consumable goods and services, and so to stimulate production and employment."[73]

[73] *Ibid.*, p. 98.

CHAPTER VIII

RATIONALISATION, WAGE AND OTHER POLICIES

1. RATIONALISATION

The rationalisation program of the 1920's in England and Europe drew a detailed discussion by Hobson on the question of eliminating the cycle. He defines rationalisation succinctly:[1]

> "The general progress of rationalisation consists in repressing competition and substituting unified control and management over production and finance in those industries that are most fundamental in relation to the needs of industry and life."

Hobson rejects[2] rationalisation as an answer to the fundamental problem of income equalisation which in turn is his answer to the savings question and the cycle. Rationalisation involves increased efficiency of capital rather than of labor and causes (1) a reduction in the number of wage-earners through greater efficiency in production, (2) shifting of employment to less skilled workers, and (3) wage-cuts forced on unions after initial unemployment. These wage effects follow from the reduced output brought about by rationalisation when left to private decisions; such rationalisation follows the profit objective and produces monopoly action. This follows for products whose demand is at all elastic; for products whose demand is relatively inelastic, the cut in real wages comes through price increases. Hobson recognizes[3] that where economies of mass-production are present there would be a desirable tendency to increase output under rationalisation and

[1] *Rationalisation and Unemployment* (London: Allen, 1930), p. 91.
[2] *Ibid.*, Ch. iv. [3] *Ibid.*, p. 65.

reduce prices thus doubly solving the equalization of income problem. He cites Bureau of Labor Statistics indices of employment, wages and production in the United States from 1919 to 1929 to show that rationalisation, which he claims has proceeded farthest in the United States, does not, on balance, act favorably, but "drives home the truth that our malady is one of distribution of income."[4]

The data used by Hobson are shown in accompanying Table II together with additional data. It has been impossible to locate precisely the material used by Hobson, but it seems clear from Table II that he is using data collected from *manufacturing industries only*. Hence Hobson is misled. Table II shows rather clearly that during periods of prosperity there is a shift within a capitalistic economy from consumption of manufactured goods to consumption of services. Thus there is a relative decline of consumption of manufactured goods, which Hobson erroneously concludes shows the bad effects of rationalisation in the United States. It will be noted that the shift to services appears in the 1920's and again in the 1940's, in the latter case being a relative shift since the absolute increase in total consumption is so high that there is an absolute increase even in consumption of manufactured goods.

Hobson presents a further proposition:[5] "The rise in wages must keep pace with the rise, not in production, but in productive power, if the balance is to be maintained." This follows his general principle that the crisis is caused by industrial realization that capacity exceeds expected consumption.

Suppose that rationalisation enables workers to get their basic necessities cheaper because of output expansion in mass-production areas and thus to spend a larger proportion of their incomes on less standardized output. What consequences follow? Hobson argues[6] that then "a limit, or at least a brake, is put upon the rationalisation movement" either through the demand for goods which cannot readily be rationalised or if all goods were rationalised then through the lack of "adequate scope for the investment of new capital." In addition, he argues rationalisation leads to monopoly which limits output and holds prices up. In the event that government interference prevents monopoly, compe-

[4] *Ibid.*, p. 73. [5] *Ibid.*, p. 76. [6] *Ibid.*, p. 81.

TABLE II

MANUFACTURING, EMPLOYMENT, WAGE AND OUTPUT DATA IN UNITED STATES, 1919–48

	Mfg. Employment Index		Mfg. Payroll Index			Index Mfg. Production	
			Current prices		$/CLI		
	1919 = 100		1919 = 100		CLI Base 1919 = 100	1919 = 100	
1919	*100*	100	*100*	100	100	*100*	100
1920	*103*	101	*124*	120	104	*104*	103
1921	*82*	77	*84*	78	76	*80*	77
1922	*90*	84	*89*	83	86	*104*	104
1923	*104*	98	*113*	105	107	*120*	120
1924	*95*	91	*104*	98	100	*117*	112
1925	*95*	93	*107*	102	101	*125*	125
1926	*96*	95	*109*	106	104	*129*	131
1927	*92*	93	*105*	104	104	*126*	130
1928	*89*	93	*103*	104	106	*132*	137
1929		98		111	113		153
1930		86		90	94		125
1931		72		68	78		103
1932		61		46	59		79
1933		68		50	68		94
1934		77		64	83		103
1935		84		82	104		121
1936		92		95	119		144
1937		100		113	138		157
1938		84		87	107		121
1939		92		102	128		151
1940		99		116	143		175
1941		122		170	200		233
1942		143		249	265		295
1943		164		340	343		358
1944		159		351	348		350
1945		140		298	289		297
1946		132		274	245		246
1947		145		338	247		270
1948		148		371	267		275

Sources: Indices computed from:

Index Manufacturing Employment: Statistical Abstract of U.S.
Index Manufacturing Payroll : Statistical Abstract of U.S.
Index Manufacturing Production : Federal Reserve Board.
Index Total Employment : Department of Commerce, 1919–28.
Economic Report to President 1951, 1929–48.

The italicized figures are those used by Hobson. Indices have been recomputed to base 1919 as 100. $/CLI means monetary amounts at current prices

Index Total Employment	Total Payroll Index		Gross National Product		
	Current Prices	$/CLI	Current Prices	$/CLI	
1919 = 100	1919 = 100	CLI base 1919 = 100	1919 = 100	CLI base 1919 = 100	
100	100	100	100	100	1919
103	118	103	112	97	1920
93	94	91	91	89	1921
97	98	102	94	98	1922
105	115	117	109	111	1923
103	115	117	108	110	1924
105	119	118	115	114	1925
110	127	124	123	121	1926
110	128	128	121	121	1927
110	131	134	123	127	1928
114	133	136	133	136	1929
107	122	127	117	122	1930
100	103	118	97	112	1931
93	80	103	74	95	1932
93	77	104	72	92	1933
98	89	116	83	108	1934
100	97	123	92	116	1935
105	111	139	109	136	1936
110	125	152	115	140	1937
105	117	144	109	135	1938
110	125	156	115	144	1939
114	135	167	130	160	1940
121	168	198	160	188	1941
131	222	236	205	218	1942
131	285	288	247	250	1943
129	317	314	271	268	1944
126	321	312	273	265	1945
133	306	273	262	234	1946
138	308	241	297	232	1947
140	366	263	332	239	1948

Index Total Payroll : Department of Commerce 1919–28.
Economic Report to President 1951, 1929–48.

Gross National Product : Economic Report to President 1951.

Cost of Living Index : Bureau of Labor Statistics. 1935–39 base.

are divided by Cost of Living Index for current year and then these amounts are indexed to the base year.

tition would not raise wages since "no separate industry [i.e., firm] stands to gain by paying higher wages than are necessary to secure the efficient labour it requires,"[7] with the result that labor does not keep pace in its share of the national income. No evidence is adduced to support this.

Unlike many would-be stabilizers, Hobson does not turn to government regulation of industry as an answer, favoring indirect controls through public finance. While private price-fixing to make the maximum profits for invested capital "must be controlled, if society is to obtain the fruits of this economy," Hobson recognizes[8] that "Where the arts of scientific invention and of organization are continually effecting new economies of cost, and are thus affording scope for individual initiative and adventure, it may well be held that public administration... is not the best way of securing for the people the fruits of the rationalising process." Hobson advocates a "surplus-profits' tax so arranged as to stimulate supply and a low price-level,"[9] under any rationalisation program.

2. PRICE REGULATION

"Price regulation, by itself, appears to involve great, if not insuperable, obstacles in some cases, as the War experience showed. For unless full publicity and reliable cost-taking are available along the whole chain of processes... it is impossible to prescribe a 'reasonable' price which will be consistent with a fully reliable supply."[10] In particular, Hobson strikes out at the increasing margins claimed by retailers. But, mainly on practical grounds, Hobson quickly disposes of price regulation as a method of dealing with the trade cycle.

3. WAGE POLICY IN THE TRADE CYCLE

Hobson gives special consideration to the question of wage reduction as a remedy for depression.[11] Although he does not recog-

[7] *Ibid.*, p. 88. The elementary misunderstanding of demand and supply which appears can only be eliminated by adding assumptions not expressed by Hobson.

[8] *Ibid.*, p. 92f. [9] *Ibid.*, p. 94. [10] *Ibid.*, p. 93. [11] *The Economics of Unemployment* (New York: Macmillan, 1922), Ch. vi.

nize the "Ricardo effect"[12] as involved in the wage lag in the upswing of the cycle, Hobson claims the wage lag contributes to "over-production." He might be construed to argue here that there is a relatively smaller advance in labor's *total* share during the upswing.[13] This appears not to be supported by Kuznets' study[14] of National Income in the United States from 1919 to 1938 as shown in accompanying Table III.

However, this would not necessarily dispose of Hobson's argument. But when these facts are considered in connection with the income-savings ratios presented in Table I, p. 82*f*, (where the materials indicate that the upper income group has much less fluctuation in the income-saving ratio than the lower income group) a much more likely hypothesis is that advanced by Kuznets:[15]

> "In view of the distinct probability that savings of upper and of lower income groups seek different investment channels, the changing distribution during business cycles of total individual savings by upper and lower income groups should be recognized as affecting the savings-investment flow."

Hobson openly takes a position against completely flexible wages, as we shall see; his logic would clearly require such a denial, since he emphasizes consumption so strongly and also considers the saving of the rich to be the volatile element.

The classical argument for a cut in real wages in depression centers around reduction of costs then in an effort to encourage

[12] Defined as the shift from more to less capital use in production as the result of the wage lag in a rising price level. Hobson sees no substitution effect.

[13] In *Rationalisation and Unemployment*, *op. cit.*, p. 79, Hobson refers to statistics showing the percentage of national income going to wage-earners in the United States rose from 37% in 1913 to 38% in 1925 and salaries from 15% to 18%. He concedes (n. 1 of p. 79) "It is, however, difficult to reconcile these statistics with those of our table... [referring to Table II supra]." In addition he recognizes the indirect increase in real wages through increased public services.

[14] Simon Kuznets: *Shares of Upper Income Groups in Income and Savings*, *op. cit.*, p. 4: "shares of the upper income groups below the top 1 per cent tended to move counter to business cycles, as did that of the top 5 per cent group as a whole." And p. 40: "—during cyclical expansions, the relative rise in incomes of upper groups is not as large as incomes of lower groups—and their relative decline in depressions is not as great."

[15] *Ibid.*

TABLE III

INCOME DISTRIBUTION, 1919–1938, TO WAGES AND UPPER GROUPS IN THE UNITED STATES

	(1) In billions Nat'l Income	(2) (current prices) Wages, salaries & other employee compensation	(3) (2) as % of (1)	(4) Percent of Total Pop. Income received by Top 1%	(5) Top 5%
1919	64.2	37.1	57.9	14.0	26.1
1920	74.2	43.9	59.1	13.6	25.8
1921	59.4	35.5	59.8	16.2	31.7
1922	60.7	37.0	61.0	15.6	30.4
1923	71.6	43.3	60.5	14.0	28.4
1924	72.1	43.3	60.1	14.7	29.1
1925	76.0	45.0	59.2	15.7	30.2
1926	81.6	48.0	58.8	15.8	30.2
1927	80.1	48.5	60.5	16.5	31.2
1928	81.7	49.4	60.4	17.2	32.1
1929	87.2	52.2	59.8	17.2	31.9
1930	77.3	47.7	61.7	15.6	30.7
1931	60.3	40.4	67.1	15.6	32.0
1932	42.9	31.7	73.9	15.3	32.1
1933	42.2	31.1	71.2	14.4	30.8
1934	49.5	34.9	70.4	13.6	29.1
1935	54.4	37.9	69.7	13.6	28.8
1936	62.9	39.8	68.0	14.7	29.3
1937	70.5	47.5	67.4	14.1	28.5
1938	65.5	44.4	67.7	12.8	27.8

Cols. 1–3 computed from Simon Kuznets, *National Income and Its Composition, 1919–1938, op. cit.*, table 22, pp. 216–217.
Cols. 4 and 5 computed from Simon Kuznets, *Shares of Upper Income Groups in Income and Savings, op. cit.*, appendix table 2, p. 67. The raw data are adjusted to give what Kuznets calls the "economic income variant" which reflects adjustment for imputed rent of owner–occupied premises, etc. See *ibid.*, pp. 5f. The top 1% reaches down to $12,800 for a family of four and top 5% down to $6,680 for a family of four (20 year averages of current prices).

the entrepreneur to resume production at a profit. When confronted with the aggregate demand objection, the classical argument is that the employment of larger numbers at the lower wage will cause the total of wage payments to be at least as great as before the cut and thus enable the larger volume of goods to move at lower prices. The conclusion of this classical argument is stated by Hobson: "A smaller proportion of this larger profit will go to labor, than of the smaller product under the higher wage-rate—But though a smaller proportion of the enlarged product thus goes to the worker, the actual amount they receive as a body will be larger than before the cut, though they will have to do more work to get it."[16]

This conclusion, classicism argues, is reached on the ground that increased employment of labor will call into play less efficient capital thus "the better-placed capital which it was worth while to employ before the wage-cut, will now be earning a higher rate of profit."[17] The comparative injustice to labor is justified on the ground that "after all, the stoppage of work and unemployment were caused directly by the inability of some of the capital to earn the necessary minimum of profit, and no remedy could be effective that did not remove this inability and restore the profit-earning power of this idle capital."[18]

One legitimate defense of this position of classicism which Hobson recognizes is the possibility that the demand for labor as a whole relative to capital is elastic.[19] Against this Hobson argues that "to produce more goods at lower labour costs will appear to add as much to the glut of supply as it does to the effective demand so that any immediate gain in volume of employment and rate of consumption may be accompanied by a prolongation of the period of depression."

Hobson phrases his attack on the classical argument with a consideration of these grounds:

1. "Wage reduction will be attended by a more than corresponding fall in efficiency and productivity of labour."[20] To this there is, Hobson recognizes, the qualification that wage-increases

[16] *Economics of Unemployment, op. cit.*, p. 86. [17] *Ibid.* [18] *Ibid.*

[19] But note that the evidence of Kuznets presented in Tables I and III might indicate the contrary.

[20] *Economics of Unemployment, op. cit.*, p. 88.

do not usually cause increased efficiency—why should decreases not operate conversely? Hobson does not find much merit in this defense by labor.

2. If wages are to be flexible, "instability of wages and of standards of living follow as a necessary consequence."[21] Labor is thus treated as a commodity. Hobson objects: "the habit of allowing wages to fall with falling prices is itself a cause of falling prices—insistence of labour on retaining a larger share of the product would be itself one important factor in controlling fluctuations of prices and trade."

3. "The refusal of such wage reduction makes for a more equal distribution of wealth, a better balance of production and consumption, and a fuller and more regular use of all factors of production."[22] A subsequent[23] study by Mendershausen indicates that:

> "During the 1929–33 depression, differences among individual incomes measured in dollars, i.e., absolute dispersion, declined uniformly, but relative dispersion (inequality) increased.
>
> Inequality within the lower income group, comprising the lower 50 to 70 per cent of the families in the various cities, increased in all cities, i.e., the share of the lowest incomes

[21] *Ibid.*, p. 90f. [22] *Ibid.*, p. 91.

[23] Horst Mendershausen, "Changes in Income Distribution During the Great Depression," *Studies in Income and Wealth*, Volume Seven (New York: National Bureau of Economic Research, 1946), pp. 114f. Mendershausen offers these explanations of the results: "The greater dispersion in bad times is ascribed to the growing importance of the income gap between employed and unemployed as well as to the unequal incidence of unemployment among low- and high-pay workers. In addition, cyclical variations in wage rate disparities between high- and low-pay jobs may contribute to the inverse correlation between changes in general income level and changes in inequality within the lower group.

"The changes in inequality within the upper group may be ascribed to differences in the cyclical flexibility of the various types of income characteristic of this group. Income from property, which accounts for a larger share of top incomes, fluctuates more than income from work, i.e., wages and salaries, which constitutes a small share of very high incomes. Therefore top incomes tend to drop more sharply in depression, and to rise more rapidly in prosperity than moderately large incomes.

"This explanation reconciles the increase in inequality throughout the economy in depression, the relatively greater fall of low-group incomes in depression than of high-group incomes and the relative increase of employee compensation during depression [pointed out above in Table III]."

> in the total income of the lower group fell, the share of the moderately low income rose. Simultaneously, inequality within the higher income group (upper 30–50 per cent) decreased in most cities. Relative differences in average income level between the lower and upper groups increased everywhere. The composite effect was to accentuate income inequality in the entire income distribution."

The findings of Mendershausen as regards relative falls have been confirmed by Kuznets, working with entirely different data:[24]

> "What happens, obviously [from the data], is that when incomes rise during cyclical expansions, the relative rise in incomes of upper groups is not as large as in incomes of lower groups; and when incomes decline during cyclical contractions, or are retarded in their rise, the relative decline in upper level incomes is not as large, or the retardation in their rise is not as large, as in incomes of lower groups."

While the Mendershausen and Kuznets studies are relevant to Hobson's hypothesis, there remains the question whether a policy of wage reduction was pursued during the Great Depression. In short, Hobson could object to the data that there had been a policy of wage reduction and hence the question cannot yet be answered what would happen if there had not been. Hobson continues: depressions are "worked out by a period of low production and low profits in which the reduced product is distributed favorably to labour, unfavourably to capital,[25] so that the rate of saving is temporarily depressed[26] and the insistence of consumers on retaining as much as possible of its [sic] normal rate of consumption gradually depletes the congested stocks."[27]

[24] Simon Kuznets, *Share of Upper Income Groups in Income and Savings, op. cit.*, p. 40 and note 10, p. 40. The Mendershausen data consists of the 1934 Financial Survey of Urban Housing by D. L. Wickens, covering income distribution in 1929 and 1933 of 33 American cities, and appear in *Studies in Income and Wealth*, Vol. Five, part II (New York: National Bureau of Economic Research, 1943). Kuznets, on the other hand, works with Federal income tax data for 1919 to 1938.

[25] As above noted, Hobson is correct in this statement. See Table III, p. 136.

[26] Again the recent materials bear Hobson out. See Table I, p. 82. The figures also support the usual consumption function theory.

[27] *Economics of Unemployment, op. cit.*, p. 92.

4. Using wage reduction as a means for cost reduction "has always operated to prevent the adoption of better ways." An easy answer to Hobson on this point, using his own logic, is that the cost reductions in factors other than labor improve the efficiency of capital, thus restoring the plethora of savings. Hobson justifies labor's resistance to technological improvements "because it fears that they signify displacement and wage-cuts."

5. Modern monopolistic practices of industry confirm the proposition that wage reductions will not lead to increased production and employment but to higher profits.[28] Here is illustrated a basic Hobsonian weakness: lack of development of investment analysis. Following Schumpeter's views, innovations lead immediately to higher profits through increased production by the innovator.[29] Hobson claims that retail profits "of the last two years [the date of the revision is 1931, of the original 1922 edition] prove the power of entrepreneurs to intercept and hold for themselves in higher margins of profit the falls in price of materials and labour in the earlier stages of production." This temporary phenomenon on the retail level is generalized so as to back Hobson's vision with regard to investment generally.

6. Hobson then considers the special case of wage reductions in export goods to facilitate England's competitive condition relative to Germany. He defends against even such a wage reduction by advocating that England "undertake lines of production and trade in which, though Germany could undersell us if she undertook them, she would not compete because her capital and labour would be more profitably absorbed in the lines where her advantages were greater."[30] This defense, however, Hobson admits would only hold in an unrestricted world-market and also only in a world-market which had not been shrunk to a size that would keep only one export nation fully employed. He concedes wage-reduction in export goods as "temporarily advantageous" through price-reduction domestically from increased volume and expansion of the foreign effective demand. Then Hobson demands international cooperation:

[28] *Ibid.*, p. 96.
[29] Joseph A. Schumpeter, *The Theory of Economic Development* (Cambridge: Harvard, 1934).
[30] *Economics of Unemployment*, *op. cit.*, p. 97.

(a) to avoid[31] "the continual danger to which higher standards of wages and living are exposed" by securing "minimum standards of wages, hours and other conditions for labor in backward industrial countries"—but in relative and not absolute terms,[32] and (b) to achieve distribution of the "world-product—more equally and equitably between labor and the other claimants."

3a. AFFIRMATIVE WAGE POLICY

The extensive consideration given to wage-reduction as a cycle measure largely determines the affirmative wage policy of Hobson. He advances "the establishment of a common rule of minimum conditions of labour and of living, in the shape of wage, hour and other conditions, made obligatory in all employments."[33] A corollary is maintenance of the wage level in depression in real terms.

So firmly imbedded is the concept of income distribution that Hobson can conclude: "I am not concerned with the wage-lag, as such, but only with its bearing upon the proportion between wages and profits. If I am right in holding that the underconsumption which visibly cramps the use of the full powers of industry is due in large part to the excessive share of the product which goes normally to 'capital' and the defective share which goes to labour, the removal of the wage-lag is only advantageous in so far as it reduces the aggregate amount of the maldistribution."[34] Removing the wage-lag helps equalize distribution but "would not of itself form a sufficient remedy." Hobson rejects any worker or employee ownership of businesses as a solution to the cycle. "The control of great combines by their employees might merely convert these employees into profiteers, whether they took their gains under the guise of high wages, or bonuses, or in some other way."[35] He is satisfied that such programs would only lead to the substitution of the elite of labor for present ownership—and not benefit the masses.

[31] This became the standard position of the International Labor Office.
[32] In this connection Hobson has in mind that the same wage rates need not prevail in real terms throughout the world, but that when rates or conditions changed in one country, there would be a corresponding (relative) change in the others as regards minima to preserve the same relative position of the respective countries. *The Economics of Unemployment*, *op. cit.*, p. 102. [33] *Ibid.*, p. 116.
[34] *Ibid.*, p. 72. [35] *Rationalisation and Unemployment*, *op. cit.*, p. 104.

4. CREDIT CONTROL IN THE TRADE CYCLE

While we have pointed out that Hobson underemphasizes the monetary aspect of the cycle, he recognizes that expansion of bank credit[36] in prosperity directs even greater profits to entrepreneurs, but he denies that bank credit can cause trouble until it is expanded *after* all resources have been mobilized. Hobson does not fear even this inflation as causing any permanent redistribution of wealth since the profits generated in the boom are the very profits lost in the following depression. He does not consider this question[37] in the event that depression does not follow for a long period of time.

One monetary aspect does disturb him. As a result of war credit policies in World War I, the debt was largely held by the capitalist classes and not lost in any subsequent depression, but perversely increased in purchasing power, both as to principal and interest in the succeeding depression, and thus further complicated income maldistribution. This situation could only be remedied by progressive taxation. Additional damage to income distribution as a result of war includes:

1. relative loss by professional and salaried classes, due to lack of organization and over-supply,
2. loss by tenant farmers to land owners by purchase of farms at high prices,
3. "levelling up" between skilled and unskilled labor, which equalizes labor income within the labor group but tends to work to the disadvantage of labor as a total as against profits.

5. PROTECTIVE TARIFF AND FOREIGN INVESTMENT AS TRADE CYCLE REMEDIES

In developing the theory of imperialism, Hobson considers the safety-valve aspect of foreign investment as an outlet for over-saving and therefore a counter-cyclical influence,[38] for underconsumptionist purposes.

[36] *The Economics of Unemployment*, *op. cit.*, ch. vii.
[37] With the single exception of *Gold, Prices and Wages* (London: Methuen, 1913) already discussed in Ch. VI, § 4a *supra*, and *Taxation in the New State* (London: Methuen, 1919), pp. 165–228.
[38] Cf. Ch. IV *supra* on theory of imperialism.

He develops the free-trade argument as best in the long-run, but prefers public finance to increase in wages as a cyclical remedy partly on the ground that British exports will not be hampered in the short-run.

In 1937[39] in viewing the great depression, he modified his views somewhat and under the head of "International Aspects of the Attack on Improperty" presents what he titles "A Flaw in Free Trade Logic."[40]

The argument that Hobson advances is that when "unemployment is rife in most of our chief manufactures it was wrong to admit foreign goods which could be made at home, employing the capital and labour which was standing idle."[41] He argues that it is possible for one country to benefit when there is general unemployment throughout the world and to benefit at the expense of other countries. There would be an offsetting factor in domestic demand shrinkage due to higher prices following upon the protective tariff. Hobson cites Adam Smith's argument from the standpoint of employment and profit of capital as applicable to employment of labor.[42] The domestic demand shrinkage due to higher prices would require employment of more capital and labor to give the original consumer the income that he requires to effect the exchange at the new higher price. He recognizes that even this national advantage will not exist "If the increased price our consumers are obliged to pay for the home-made goods substituted for exports is very large." He does not so state, but he is referring to the relative elasticities of demand for the products, former imports and original domestic products. He concedes that this temporary situation creates difficulty later when the world returns to full employment and he concedes that monopolistic practices are encouraged by such a program.

[39] *Property and Improperty. op. cit.*
[40] *Ibid.*, pp. 124 to 131.
[41] *Ibid.*, p. 124.
[42] *Ibid.*, p. 126.

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