

THE PRINCIPLES
OF
POLITICAL ECONOMY



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BY

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AUTHOR OF "THE METHODS OF ETHICS."

'Tis the day of the chattel,
Web to weave and corn to grind:
Things are in the saddle,
And ride mankind.

EMERSON.

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PREFACE.

THE character and scope of this treatise I have endeavoured to explain fully in the introductory chapter; it remains for me here to acknowledge my debts to the works that have chiefly aided me in composing it. After J. S. Mill's book, from which I first learned political economy, and on which the present work must be understood to be primarily founded, I believe that I owe most to Jevons' *Theory of Political Economy*, the leading ideas of which have been continually in my thoughts—though I have had occasion to dissent from many of Mr Jevons' particular opinions. I am also considerably indebted—in spite of still more fundamental disagreement—to Cairnes' *Leading Principles of Political Economy*: and also to the *Economics of Industry*, by Mr and Mrs Alfred Marshall, together with some papers by Mr Marshall on the theory of Value diagrammatically treated, which have been privately lent to me. I have also derived valuable suggestions from Mr Hearn's *Plutology*, and from Mr F. A. Walker's *Wages*; also from Mr Macleod, as

regards the theory of Money, and to some extent in treating of Wealth and Capital—though I do not agree with Mr Macleod's views about either of these fundamental terms, and am obliged to dissent most strongly from his general treatment of economic science. I must also express my obligations to the writer of an article on 'Industrial Monopolies' in the *Quarterly Review* of October, 1870.

Among foreign writers, I have derived most assistance from the works of Professors A. Held and A. Wagner; especially from the latter's elaborate systematic treatise on the subject.

Finally, I must acknowledge gratefully the aid that many friends have kindly given me, by supplying information or suggesting corrections required for various portions of the work while it was in progress; among whom I must particularly mention Mr F. W. Maitland, of Lincoln's Inn, and Mr J. N. Keynes, of Pembroke College, Cambridge. To the latter I am especially indebted for his kindness in reading and criticising the proof-sheets of the greater part of the book: which has enabled me to improve it in many respects.

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CORRIGENDA.

On p. 186, line 7 from bottom, *for* "rises" *read* "falls"

On p. 219, line 4 from bottom, *transpose* "A" and "B"

On p. 220, line 10 from bottom, *for* "A" *read* "B"

On p. 253, line 8 from top, *for* "change" *read* "increase"

On p. 253, line 13 from top, *for* "creditors" *read* "debtors"

On p. 255, line 23 from top, *for* "rise" *read* "fall"

On p. 386, line 11 from top, *for* "class" *read* "place"

On p. 402, note 1 ad fin.

for "desire wealth obtainable by some other kind of labour more than they dislike that other kind"

read "prefer some other kind of labour either for its own sake or for its results"

On p. 479, line 10 from bottom, *for* "philosophic" *read*
"philanthropic"

On p. 492, line 8 from top, *for* "tax" *read* "productional disadvantage"

On p. 497, line 5 from bottom, *for* "overrating" *read* "enervating"

On p. 506, line 6 from bottom, *for* "when" *read* "where"

On p. 513, last line,

for "this has been denied by modern socialists"

read "modern socialists have held that this result would be brought about"

On p. 539, line 3 from top, *for* "wealth" *read* "health"

INTRODUCTION.

CHAPTER I.

THE PRESENT STATE OF ECONOMIC CONTROVERSY IN ENGLAND AND THE SPECIAL AIM OF THE PRESENT WORK.

§ I. SOME twenty years ago, both the Theory of Political Economy in its main outlines, and the most important practical applications of it, were considered as finally settled by the great majority of educated persons in England. Two causes appear to have chiefly cooperated in producing this result. The prosperity that had followed on the abolition of the corn-laws had given practical men a most impressive and satisfying proof of the soundness of the abstract reasoning by which the expediency of Free Trade had been inferred; and a masterly expositor of thought (J. S. Mill) had published in a convenient treatise a skilful statement of the chief results of the controversies of the preceding generation; in which the doctrines of Ricardo were presented with many of the requisite explanations and qualifications, and much of what was sound in the objections and supplementary suggestions of other writers was duly taken into account. It seemed that the science had at length emerged from the state of polemical discussion on fundamental notions and principles, and that whatever further remained to be done

would be building on a foundation already laid. J. S. Mill's language had a considerable share in producing this belief. Since Locke, no English thinker who has exercised so wide and intense an influence on his contemporaries, has been generally so little open to the charge of overrating the finality—as regards either substance or form—of the theories he has expounded: and no one since Bacon has been more concerned to point the way to the illimitable worlds of knowledge that remain to be conquered. Hence it is all the more remarkable that he should commence his account of value with the unhesitating assertion that “there is nothing in the laws of value which remains for the present or any future writer to clear up: the theory of the subject is complete.” It is not surprising that the younger generation, to whom his treatise soon became the chief—and often the sole—source of economic knowledge, should be equally confident; and that it should become the fashion to point to Political Economy as unique among Moral Sciences for the clearness and certainty of its method and the admitted trustworthiness of its conclusions.

Probably many of the generation taught by J. S. Mill are not aware how very recent is the date of this confident tone. In fact, however, during the second quarter of the present century almost every English writer on Political Economy took note in some form or other of the rudimentary and unsettled condition of his study. For example, Senior, in an Introductory Lecture delivered before the University of Oxford in 1826, spoke of the science as “in that state of imperfect development, which...throws the greatest difficulty in the way of a beginner and consequently of a teacher, and offers the fairest scope to the objections of an idle or interested adversary.” Malthus¹ in the following year remarked that “the differences of opinion among political economists” have “of late been a frequent subject of complaint.” The Edinburgh Reviewer of M'Culloch's first edition (1831) characterized Political Economy as a “moral science of which the doctrines are not recognised”: and M'Culloch himself, through his successive editions, was obliged to note that “the differences

¹ *Definitions in Political Economy* (preface).

“which have subsisted among the most eminent of its professors
 “have proved exceedingly unfavourable to its progress, and
 “have generated a disposition to distrust its best established
 “conclusions.” Even in 1852 when Senior again addressed the
 University of Oxford, he announced that his subject was still
 “in a state of imperfect development,” and devoted his first
 lecture to an explanation of “the causes that have retarded its
 “progress.”

No doubt many of these writers express a confident hope
 that this ‘retardation’ will soon cease. McCulloch has no doubt
 that “the errors with which the science was formerly infected
 “are fast disappearing,” and Colonel Torrens ventures to prophesy
 more definitely that “twenty years hence there will scarcely
 “exist a doubt respecting any of its more fundamental principles.”
 And by the time that Mill’s work had gone through several
 editions an impression began to prevail widely that this better
 time had actually arrived. The generation whose study of
 Political Economy commenced about 1860 were for the most
 part but dimly conscious of the element of stormy controversy
 from which the subject had so recently emerged¹. It is

¹ The following extract from the *Edinburgh Review*, Vol. 114, seems to me
 to represent accurately the view of the subject which was current about the time
 (1861) that it was written: and it is all the better evidence of the general state of
 opinion, because it occurs incidentally in an article on ‘English Jurisprudence.’
 “That some departments of human conduct are capable of being classified
 “with sufficient exactness to supply the materials of a true science is conclu-
 “sively proved by the existence of Political Economy.”.....“Political Economy
 “is the only moral science in which definitions of fundamental terms suffi-
 “ciently accurate to obtain general currency amongst all persons conversant
 “with the subject have yet been produced. The consequence has been that
 “the conclusions of those who understand the science are accepted and acted
 “on with a degree of confidence which is felt in regard to no other speculations
 “that deal with human affairs. Political Economists can appeal to the only test
 “which really measures the truth of a science—success—with as much con-
 “fidence as astronomers. The source of their success has been that they have
 “succeeded in affixing a precise meaning to words which had for ages been
 “used by millions who attached to them vivid but not definite notions, such as
 “wages, profits, capital, value, rent, and many others of the same kind.”

The preface to Professor Fawcett’s Manual—first published in 1863—ex-
 hibits the same undoubting confidence in the established scientific character of
 Political Economy. It begins with the following sentences:

“I have often remarked that Political Economy is more frequently talked
 “about than any other science, and that its principles are more frequently

true that there were still loud voices heard on the opposite side; but comparatively little notice was taken of them. For instance, the condemnation of Political Economy by Auguste Comte was generally disregarded—in spite of the great and growing interest that was then taken in the Positive Philosophy—as being plainly irrelevant to Mill's exposition of the subject; in fact, it seemed to be based on a misunderstanding nearly as palpable as that involved in the vulgar dislike of the political economist as a preacher of the gospel of Mammon and selfishness. I hardly think that even the eloquent diatribes of Mr Frédéric Harrison¹ induced any considerable number of readers—outside the working classes—even to doubt the established position of economic science. Nor did the elaborate attacks made by Mr Macleod² on the received doctrines succeed in attracting public attention: his books were bought and read, but were valued almost exclusively for their information on the special subject of Banking. Mr F. D. Longe's refutation of the Wages-Fund Theory (1867) fell quite dead: even the *Quarterly Review*—which in 1871 attacked Mr Thornton for ignoring his obligations to Mr Longe, and sneered at Mill for admitting when urged by a friend a hostile argument to the force of which he had previously remained deaf—had up to that date never found occasion to mention Mr Longe's name.

In 1871, however, these halcyon days of Political Economy had passed away. Their termination was of course not abrupt; but so far as any date can be fixed for it, I should place it at the appearance of Mill's notice of Mr Thornton's book *On Labour* in the *Fortnightly Review* of March, 1869. I do not think that the work itself, apart from the review, would have produced so much effect; since Mr Thornton's criticism of the Theory of Value showed so serious a misapprehension of the general relation which economic theory necessarily bears to economic facts, that a disciple of Mill might be pardoned for

“appealed to in the discussions of ordinary life. No science, however, is perhaps more imperfectly understood. I believe that profound mathematicians, or accomplished geologists and botanists, are far more numerous than real masters of the principles of Political Economy.”

¹ Cf. *Fortnightly Review*, 1865.

² In his *Theory of Banking*, 1855-6, and his *Dictionary of Economical Philosophy*, 1863.

underrating the real use and importance of this and other parts of Mr Thornton's book. But the manner in which Mill replied to this criticism appeared to most of his disciples highly unsatisfactory, and the facility with which he resigned a doctrine (the old 'Wages-Fund Theory') which he had taught for years caused them an unexpected shock; thus they were naturally led to give a more respectful attention not only to Mr Thornton's assaults, but also to other utterances of dissent from economic orthodoxy to which they had hitherto turned a deaf ear. A second shock was given in 1871 by the publication of Professor Jevons' *Theory of Political Economy*; which took up in reference to the received mode of treating the subject an attitude almost similar to that which each new metaphysical system has hitherto adopted towards its predecessors. Again, in 1874, Cairnes' *Leading Principles of Political Economy*, though written by a disciple of Mill and in fundamental agreement with his doctrines, still contributed to impair the unique prestige which Mill's exposition had enjoyed for nearly half a generation. As a controversialist Cairnes, though scrupulously fair in intention, was deficient in intellectual sympathy; he could hardly avoid representing any doctrine that he did not hold in such a way as to make it almost inconceivable to his readers that it could possibly have been maintained by a man of sense; and when this treatment was applied to some of his master's most important statements, the expressions of personal regard for Mill by which it was accompanied only made the result seem more damaging to a reader who was convinced by Cairnes' reasoning. Meanwhile the strife between Labour and Capital had come to occupy more and more of the attention of cultivated society; and the conviction had gradually gained ground that Political Economy had failed to ascertain the "law "that determines the stable equilibrium of work and wages"¹"; and even that "the attempt to solve great industrial questions "on the hypothesis which Mr Mill states to be the fundamental "one of Political Economy"—i.e. that men are governed by self-interest only—"is to confuse rather than to elucidate the "problems which it behoves us to investigate."

¹ Cf. *Edinburgh Review*, 138, 1873.

In short, when the concluding quarter of this century began, it was evident that Political Economy had returned to the condition in which it was in the second quarter; and that M^cCulloch's melancholy admission that "the differences which "have subsisted among the most eminent of its professors have "proved exceedingly unfavourable to its progress, and have "generated a disposition to distrust its best established conclusions" was again only too applicable. This unfortunate result would, I think, have been brought about merely by the disputes and divergences of opinion among economists who adhered to the mode of treating the subject which has prevailed in England since Ricardo. But a powerful contribution to it has been supplied by a thoughtful and independent writer, Mr Cliffe Leslie; who in 1870, in an article on the Political Economy of Adam Smith, began that attack on the 'Ricardian' or 'à priori' method which he has continued in several subsequent articles, recently reprinted in *Essays Moral and Political*. One part of Mr Cliffe Leslie's work consisted in drawing the attention of English economists to the movement in opposition to their method which had for some time been carried on in Germany, and which, during the last twenty years, has continually gained strength. The leaders of this movement, however widely they also differ among themselves, are generally agreed in repudiating as "Manchesterthum"—or even "Smithianism"—the view of Political Economy mainly adopted in England; and their influence constitutes an additional force under which the disputes as to particular doctrines among the English Economists tend to broaden into more fundamental controversy as to the general method of dealing with economic questions.

At the same time the opposition of influential artisans to Political Economy has not diminished, as is apparent from Mr Howell's *Conflict of Labour and Capital*; it has only changed somewhat from sullen distrust to a tone of more confident contempt. While, finally, the great practical success of Free Trade—which, as I said at the outset, contributed largely to the prestige enjoyed by Political Economy during its halcyon days in the third quarter of this century—has recently been called in question by an apparently growing party of

practical men; and is certainly rendered dubious through the signal disappointment of Cobden's confident expectations that the example of England would be speedily followed by the whole civilised world.

§ 2. This brief sketch of the recent history and present condition of Political Economy in England has seemed to me necessary in order to explain the exact aim of the present work; which on the one hand makes no claim to originality, while on the other hand it is not precisely an elementary treatise. It is written in the belief that the reaction above described against the treatment of Political Economy as an established science was inevitable and even salutary; but that it has been carried too far, so that the waves of disputation are in danger of submerging the really sound and valuable results of previous thought. My primary aim, then, has been to eliminate unnecessary controversy, by stating these results as guardedly as possible, and with due attention to the criticisms and suggestions of recent writers. Several valuable contributions to abstract economic theory have been made by Cairnes, Jevons, Macleod, and other English writers; but in my opinion they are generally of less relative importance than their authors suppose, and admit of being stated in a form decidedly less hostile to the older doctrines. In the same way I think that the antithesis between the Inductive and Deductive Methods has been stated by writers on both sides in needlessly sharp and uncompromising terms. I shall endeavour to show¹ that there is an important part of the subject to which economists are generally agreed in applying a mainly inductive or "realistic" treatment. On the other hand, few, I think, would deny the utility and even indispensability of deductive reasoning in the Theory of Distribution and Exchange; provided only the assumptions on which such reasoning proceeds are duly stated, and their hypothetical character continually borne in mind. I fully admit the importance of this latter proviso; accordingly in those parts of this work in which I have used chiefly deductive reasoning, I have made it my special aim to state explicitly and keep clearly in view the limited and conditional applicability of the conclusions attained by it.

¹ Cf. *post*, Chap. III.

With this view I have been generally careful to avoid any dogmatic statements on practical points. It is very rarely, if ever, that the practical economic questions which are presented to the statesman can be unhesitatingly decided by abstract reasoning from elementary principles. For the right solution of them full and exact knowledge of the facts of the particular case is commonly required; and the difficulty of ascertaining these facts is often such as to prevent the attainment of positive conclusions by any strictly scientific procedure.

At the same time the function of economic theory in relation to such problems is none the less important and indispensable; since the practical conclusions of the most untheoretical expert are always reached implicitly or explicitly by some kind of reasoning from some economic principles; and if the principles or reasoning be unsound the conclusions can only be right by accident. For instance, if a practical man affirms that it will promote the economic welfare of England to tax certain of the products of foreign industry, a mere theorist should hesitate to contradict him without a careful study of the facts of the case. But if the practical person gives as his reason that "one-sided free trade is not free trade at all," the theorist is then in a position to point out that the general arguments in favour of the admission of foreign products are mostly independent of the question whether such admission is or is not reciprocated. So again, if an enlightened farmer argues that, in the present agricultural depression, a restriction of freedom of contract and freedom of bequest is imperatively required, it would be presumptuous to affirm dogmatically on abstract principles of *laissez-faire*, that such restrictions are undesirable. But if the farmer explains that these restrictions are required in order that more capital may be applied to the land, it then becomes opportune to show him that *if* land in England is cultivated, on the average, with an amount of capital larger than that which would give the greatest proportional produce, and *if* the fall in farmers' profits is due to increased facilities of foreign importation, then his loss would only be aggravated by the mere application of more capital to the land. And similarly in dealing with other questions of the day, abstract economic arguments almost always come in, and are almost never by themselves decisive.

In thus making prominent the hypothetical character of the deductive reasonings of Political Economy, I am merely following the lines laid down by J. S. Mill in his general account of economic method—as expounded most fully in his *Essays on Unsettled Questions in Political Economy* (1843). This view of the subject rendered his whole treatment of it more profoundly different from that of Ricardo and James Mill, than is at first apparent to hasty readers; though, as was only natural, the modifications which its consistent application required in the old doctrine were not always carried out with perfect precision and completeness. Still, the work that was actually done by Mill in supplying corrections, limitations and reserves to the dogmatism of the earlier Ricardian school, seems to me quite as important as the work of the same kind which in my opinion still remains to be done. On this point I regret to find myself in decided conflict with the deservedly high authority of Professor Jevons. In the preface recently published to the second edition of his *Theory of Political Economy*, Mr Jevons announces as a conclusion to which he is “ever more clearly coming, that “the only hope of attaining a true system of Economics is to “fling aside, once and for ever, the mazy and preposterous “assumptions of the Ricardian School¹.” He subsequently speaks of the doctrines of this school as “Ricardo-Mill Economics,” explaining how “that able but wrong-headed man, “David Ricardo, shunted the car of economic science on a “wrong line, a line, however, on which it was further urged “towards confusion by his equally able and wrong-headed “admirer, John Stuart Mill².”

The expression of opinion in these passages appears to me exaggerated and violent, even so far as Ricardo is concerned; while so far as it applies to Mill I cannot but regard it as entirely false and misleading. I certainly should agree with Mr Jevons in deprecating as excessive and overstrained the eulogistic language in which many competent judges have described the work of Ricardo. Though undoubtedly an original and important thinker, I cannot perceive that Ricardo was a thoroughly clear and consistent reasoner; and it has always

¹ *Theory of Political Economy*, preface, p. xlix.

² *L. c.* p. lvii.

seemed to me highly unfair to the deductive method of economics to treat Ricardo's writings as a peculiarly faultless specimen of its application. At the same time I hold that many of the characteristic doctrines of Ricardo, stated with proper qualifications and reserves, ought to find a place in any complete exposition of economic theory; and I have been careful to give them, in the present treatise, the place which appears to me to belong to them: though I equally hold that the statement of them by Ricardo himself has frequently serious, and sometimes glaring, deficiencies¹. But when Mr Jevons goes on to say, in a rather unusual flight of rhetoric, that Mill "urged "the car of economic science further towards confusion" on the "wrong line" on which Ricardo had shunted it, I am really unable to conjecture how he would support a statement which appears to me so perverse. He cannot, I think, refer to the general theory of Value, where Mill corrects and supplements Ricardo's view, by giving due place to the operation of Supply and Demand in the determination of market-price; and where he quietly gets rid of Ricardo's serious confusion between Measure of Value and Cause or Determinant of Value. Nor can he have been thinking of the theory of Rent; for here Mill's exposition of the Ricardian doctrine is improved and guarded in several important respects; especially by the account taken of Carey's indisputable limitation of the law of diminishing returns, and by the stress laid on the influence of general industrial progress in counteracting this law. Nor, again, can he have in view the theory of Wages and Profits; in which, among other improvements, Mill reduces to harmlessness Ricardo's dangerous paradox that "wages cannot rise without profits "falling." Nor, finally, can his statement relate to the theory of International Values; since he expressly says that this is probably the most valuable part of Mill's work. But if

¹ It may be observed that the amount of correction required is very different in respect of different doctrines. In some cases, as in the determination of Wages and Profits, while recognising an element of truth in Ricardo's view, I think that the defects of his doctrine are beyond patching, and that an entirely new treatment of the subject has to be adopted. On the other hand, as regards the relation of Value to Cost of Production, Ricardo's doctrine is of fundamental importance (though requiring to be qualified and supplemented); and any teaching which ignores or obscures it appears to me fatally defective.

Mr Jevons' charge cannot be justified in relation to any of the four topics that I have mentioned, it is difficult to conceive how so strong a statement can possibly be justified at all. It must be admitted that on more than one important point Mill has not made clear to the reader the interval that separates his doctrine from Ricardo's: which, with Mr Cliffe Leslie, I partly attribute to that "piety of a disciple" which Mill always manifests towards Ricardo's teaching. This disposition has had some unfortunate consequences, and must be regarded as a weakness; still, in a subject where most writers have shown so marked a tendency to emphasize the novelty of their ideas, and exaggerate their divergence from their predecessors, it appears to me a weakness that "leans to virtue's side."

CHAPTER II.

SCOPE OF POLITICAL ECONOMY.

§ 1. **POLITICAL** Economy, in England at least, is now almost universally understood to be a study or inquiry concerned with the Production, Distribution, and Exchange of Wealth. I shall hereafter try to show that, unless we either inconveniently restrict the range of our discussions or strain the ordinary use of language, we shall find it needful, in certain important parts of the inquiry thus designated, to substitute for Wealth other terms with somewhat different denotations. This change, however, will be more conveniently explained and supported in a subsequent chapter; and, since the relations of men to Wealth will in any case constitute the chief object of our study, we may acquiesce provisionally in the definition above given. A more fundamental divergence of opinion relates to the point of view from which Political Economy contemplates these relations. Is it concerned with "what is" or with "what ought to be"? Is its aim to establish certain general propositions, either positively or hypothetically true, respecting the coexistence and sequence of facts, or to give practical rules for guiding the public conduct of statesmen and men of business? Is it, in short—to use an old distinction recently revived in this connexion—a Science or an Art? The former view is that which has been adopted, I believe, by all writers on economic theory in England for the last thirty years. No doubt an important part of the subject as treated by Mill and other systematic writers belongs admittedly to Art rather than to Science; viz. the discussion of the principles on which Taxation should be managed and of the general nature and limits of Governmental

interference, so far as it affects the amount or the distribution of the national wealth. But these matters are generally handled by the writers in question under the head not of Political Economy strictly speaking, but of its application to Politics or the Art of Government. They hold that the precepts or rules of this department of practice are properly based, in a great measure, on the generalisations or deductions of Economic Science; but they do not mean these rules of Art when they speak of the 'laws of Political Economy'; and they have frequently censured as a vulgar error the habit of thinking and speaking of economic 'laws' as liable to 'violation,' and as needing to be realised by voluntary conformity or even enforced by public opinion. Still this habit has been found very difficult to eradicate¹; and indeed, the sharp distinction which English economists are at present disposed to draw between Economic Theory and its application to practice is almost confined to themselves and their more docile disciples: it has not worked itself into the common thought of even cultivated persons here, and it has not been generally accepted by Continental writers. When, in discussing the same matters, one set of disputants blend the consideration of 'what exists' or 'tends to exist' with the consideration 'what ought to be,' while another set carefully separate the two questions, the gravest misunderstanding is likely to result.

Hence it seems very important to examine carefully the

¹ It would be unfair to represent as typical the following remarks of an Edinburgh Reviewer on the 'law of supply and demand' as 'determining the payment of labour'; but their appearance in a first-class organ of opinion is a striking illustration of the widespread and inveterate character of the error they contain. "Laws," observes the writer (*Ed. Rev.* Oct. 1867, p. 446), "are of no avail unless means are provided for their execution": and he urges that "trade-unions, instead of simply enforcing the law of the market, resort to illegal and extortionate action in order to strain that law to their own advantage, thereby excluding the action of supply and demand by forcibly cutting off supply." This, however, is an extreme case, and probably no instructed person would now speak of economic laws exactly in this way. But the same fundamental notion is still often suggested, though more vaguely and implicitly, by the best educated speakers and writers. For instance, in the discussion of bills in the parliament of 1880 there were frequent references to Political Economy: and in such references it was almost always implied that Political Economy prescribes "freedom of contract," and does not merely assume it as a condition of the applicability of its conclusions.

causes and the justification, if there be any, of this widespread confusion—or at least fusion—of distinct inquiries.

§ 2. The causes are partly historical or linguistic; partly, again, they lie deep in the nature of the subject and the normal conditions of the application of the human intellect to practice. To begin with the former, we may observe that the generic term Economy has always denoted an Art rather than a Science, and that it has naturally been found difficult to alter its meaning altogether in prefixing to it the epithet Political; especially since, the compound 'politico-economical' having been found unendurable, the simple 'economical' has been used to do adjectival duty both for 'economy' and 'political economy.' Recent writers, it is true, have generally used 'economic' as the adjective corresponding to 'political economy': but though they have thereby obviated an ambiguity of language, they have not done away with the general impression that Political Economy is one branch of a larger subject which includes, e.g., Domestic Economy as another branch. This, of course, was the relation of the two studies as originally conceived: otherwise the term Political Economy would never have come into use. It was because a monarch or statesman was conceived to have the function of arranging the industry of the country somewhat as the father of a family arranges the industry of his household, that the Art which offered him guidance in the performance of this function was called Political Economy. Let us turn, for example, to Sir James Steuart, the first of our systematic writers; who, had he but seen through the fallacies of the Mercantile System, would have been deservedly regarded as the father of English Political Economy.

Steuart's *Inquiry into the Principles of Political Economy* (published 1767) commences with the following account of the subject.

"Economy in general is the art of providing for all the wants of a family with prudence and frugality.....The whole economy must be directed by the head, who is both lord and steward;.....as lord he establishes the laws of his economy, as steward he puts them into execution.....

"What economy is in a family, Political Economy is in a state,.....but the statesman is not master to establish what

“form of economy he pleases;...the great art therefore of Political Economy is first to adapt the different operations of it to the spirit, manners, habits and customs of the people, and afterwards to model these circumstances so as to be able to introduce a set of new and more useful institutions.

“The principal object of this science is to secure a certain fund of subsistence for all the inhabitants, to obviate every circumstance which may render it precarious; to provide everything necessary for supplying the wants of the society, and to employ the inhabitants (supposing them to be freemen) in such a manner as naturally to create reciprocal relations and dependencies between them, so as to make their several interests lead them to supply one another with their reciprocal wants.....Political Economy in each country must necessarily be different;.....it is the business of a statesman to judge of the expediency of different schemes of economy, and by degrees to model the minds of his subjects so as to induce them, from the allurements of private interest, to concur in the execution of his plan.”

Nine years after Steuart's book was published appeared the epoch-making *Wealth of Nations*, enforcing an essentially different view of a statesman's duties. But notwithstanding the gulf that separates Adam Smith's economic doctrine from Steuart's, he is equally decided in defining Political Economy as an Art¹. “Political Economy,” he says, in the introduction to the fourth book, “proposes two distinct objects: first, to provide a plentiful revenue or subsistence for the people, or, more properly, to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or common weal with a revenue sufficient for the public service. It proposes to enrich both the people and the sovereign.” Accordingly by the “systems of Political Economy” of which he treats in this book he seems at the outset to mean not systems in the scientific sense, i.e. connected sets of general statements

¹ No importance is to be attached to the fact that Steuart, Adam Smith, and others call Political Economy a Science while defining it as (what we should now call) an Art. The present general recognition of the distinction between the two terms, in its application to economic matters, is due, I think, to the combined influence of Senior and J. S. Mill, and cannot be traced further back. McCulloch, for instance, altogether ignores it.

of fact; but modes of organized governmental interference with a view to "enriching the people and the sovereign." But each of these systems was of course based upon certain quasi-scientific principles, a certain view of economic facts; for instance, the "mercantile" system of restraints on importation, encouragements of exportation, &c., rested on the supposition that the balance of gold and silver procured by any branch of national industry and commerce was a trustworthy criterion of its advantage to the country¹. Hence in his discussion of the mercantile system Adam Smith naturally expounds and refutes this quasi-scientific doctrine (and the confusions and errors on which it was founded) along with the practical deductions drawn from it; though he is chiefly occupied in describing these latter and tracing their consequences. So far there is no particular disadvantage in the ambiguity of the term 'system'; as it might legitimately denote either a body of scientific doctrines or a set of practical precepts, there is no confusion involved in using it for a combination of the two.

But when Adam Smith passes in Ch. IX. to treat of the "Agricultural Systems," the ambiguous term becomes a manifestly awkward instrument for the conveyance of his meaning, and is certainly liable to cause a confusion in the reader's mind. For we naturally expect to find in an agricultural 'system' the same kind of organized governmental interference in the interest of agricultural producers that we found in the mercantile system in the interest of manufacturers and merchants; and in fact Adam Smith's own language

¹ A whole series of economic writers, since Adam Smith's time, have attributed to the advocates of the Mercantile System the absurd delusion that "wealth consists solely in the precious metals." It is only due to our ancestors to say that the charge, in the broad way in which it is ordinarily stated, is a manifest exaggeration of a polemical inference of Adam Smith. He expressly says that "some of the best English writers upon commerce set out with "observing that the wealth of a country consists, not in gold and silver only, "but in its lands, houses, and consumable goods of all different kinds." But he observes that "in the course of their reasonings, however, the lands, houses "and consumable goods, seem to slip out of their memory; and the strain of "their argument frequently supposes that all wealth consists of gold and "silver." The last sentence is perhaps a fair *reductio ad absurdum* of the mercantile system: but it is certainly not a fair statement of its explicit doctrine.

expressly suggests this antithesis. He introduces his account of the views of Quesnay and the other French Physiocrats, which occupies two-thirds of this chapter, by a reference to Colbert's protective policy; remarking that "as in the plan of Mr Colbert the industry of the towns was certainly overvalued in comparison with that of the country, so in their system it seems to be as certainly undervalued." He passes on from his discussion of the Physiocrats to speak of the policy of China, Indostan and ancient Egypt, which, as he says, "favours agriculture more than all other employments"; he also refers to the ancient republics of Greece and of Rome, whose policy "honoured agriculture more than manufactures (though it seems rather to have discouraged the latter employments than to have given any direct or intentional encouragement to the former)." And he concludes by arguing that "those agricultural systems...which preferring agriculture to all other employments, in order to promote it, impose restraints upon manufactures and foreign trade...really and in the end discourage their own favourite species of industry...and are therefore more inconsistent than the mercantile system"; and that, therefore, "all systems of preference and restraint should be completely taken away." Hence the careless reader might excusably carry away the impression that Quesnay's doctrine, which was certainly a "system of preference" for agriculture, was like the "plan of Mr Colbert," a system of legal regulation and restraint: and even the careful reader, if not previously informed on the subject, must be startled when he suddenly learns that in Quesnay's view "perfect liberty" was "the only effectual expedient" for encouraging agriculture; and that the only positive governmental interference proposed by the Physiocrats, as a deduction from their speculative preference for agriculturalists, was the raising of all revenue by an "impôt unique" on rent.

The truth is that Adam Smith has really not seen the extent to which, in the hands of the Physiocrats as well as his own, the method of Political Economy has changed its fundamental character and become the method of a science rather than an art: since the change is due not to any difference in the question primarily asked by the economic

inquirer, but to the entirely different answer now given to it. The question is still the same, "How to make the nation as rich "as possible": but as the answer now is "By letting each "member of it make himself as rich as he can in his own way," that portion of the old art of Political Economy which professed to teach a statesman how to "provide a plentiful revenue or "subsistence for the people" becomes almost evanescent: since the only service of this kind which the sovereign can render—besides protecting his subjects from the violence of foreigners and from mutual oppression and injustice—is to "erect and "maintain certain public works and certain public institutions, "which it can never be for the interest of any individual, or any "small number of individuals, to erect and maintain." What remains for Political Economy to teach the statesman is merely how to provide himself with a "revenue sufficient for the public "services" in the best possible way: and accordingly such teaching, since Adam Smith's time, has constituted the sole or chief part of Political Economy considered as an art. As regards the "plentiful revenue or subsistence of the people," Adam Smith, instead of showing the statesman how to provide it, has to show him how Nature herself would make ample provision if only the statesman would abstain from interfering with her processes: instead of recommending laws (in the jurist's sense) by which the national production and distribution of wealth *ought to be* governed, he has to trace the laws (in the naturalist's sense) by which these processes actually *are* governed. In short, the substance of his economic doctrine naturally leads him to expound it in the form of the science to which later writers have applied the name of Political Economy; before entering (in Book v.) on the discussion of the principles of the Art previously so called—so far as he allows it a legitimate existence—that is, the principles of governmental expenditure and taxation¹.

§ 3. But however great the change that was thus made,

¹ It seems clear that Adam Smith does *not* mean to call his *Inquiry into the Nature and Causes of the Wealth of Nations*, as conducted in the first two books of his treatise, a "theory of Political Economy"; whereas it is the only portion of his work to which we should give this appellation, according to the strictest current usage.

through the teaching of the Physiocrats and Adam Smith combined, in the current conception and exposition of Political Economy, it is important to observe that the transition thus effected from Art to Science was, in the nature of the case, incomplete. Political Economy became primarily a study of 'what is' rather than of 'what ought to be': but this was because the two notions were, at least to a considerable extent, identified in the political economist's contemplation of the existing processes of the production and distribution of wealth. He described and analysed these processes, not only to show what they were, but also to show that they were not likely to be improved by human restraints and regulations. This is true not only of Adam Smith, but of almost all his disciples and successors for more than half a century. It should be noted, however, that they have maintained this identity of the actual with the ideal in very different degrees and on very different grounds; and that a considerable amount of mutual misunderstanding and mistaken inference has resulted from not observing these differences. Such misunderstanding has been a good deal aided by the ambiguity of the term 'Natural,' applied by Adam Smith, Ricardo and others, to the shares of different producers, as determined by the economic laws which these writers expound. For by the term 'natural' as commonly used, the notion of 'what generally is,' or 'what would be apart from human interference,' is suggested in vague combination with that of 'what ought to be' or 'what is intended by a benevolent providence': and it is not always easy to say in what proportions the two meanings are mixed by any particular writer. Indeed it is somewhat difficult to determine this even in the case of Adam Smith himself. There is no doubt that—as Mr Cliffe Leslie¹ has pointed out—Adam Smith's advocacy of the "obvious and simple system of natural liberty" is connected with his strongly marked theistic and optimistic view of the order of the physical and social world. He is convinced that "all the inhabitants of the universe are under the immediate care and protection of that great, benevolent, and all-wise Being, who directs all the movements of nature, and who is determined, by his own

¹ In an essay on the Political Economy of Adam Smith, recently reprinted in *Essays in Political and Moral Philosophy*.

“unalterable perfections, to maintain in it, at all times, the “greatest possible quantity of happiness”¹: and this conviction gives him a peculiar satisfaction in tracing the various ways in which the public interest is “naturally” promoted by the spontaneous cooperation of individuals seeking each the greatest pecuniary gain to himself. At the same time he is too cool an observer of social facts to carry this optimism to an extravagant pitch. He takes care to point out, for instance, that the “interest of the employers of stock” has “not the same connexion “with the general interest of society” as that of landlords and labourers: and even that “the interest of the dealers in any “particular branch of trade or manufactures is always in some “respect different from and even opposite to that of the “public.” So again when he speaks of “hands *naturally* “multiplying beyond their employment” in the stationary state of a country’s wealth, and describes the “starving condition of “the labouring poor as a *natural* symptom of the declining “state,” we can hardly suppose that the term “natural” is intended directly to imply the design of a benevolent Providence. The Natural is here what actually exists or what tends to exist according to general laws, apart from casual disturbances and deliberate human interference. In consideration of these and similar passages we should, I think, refrain from attributing to Adam Smith a speculative belief in the excellence of the existing arrangements for producing and distributing wealth, to any further extent than is required to support his practical conclusion that they were not likely to be bettered by the interference of government. Still less should we attribute to him any intention of demonstrating that these arrangements realise distributive justice, in the sense that each man’s remuneration is an exact measure of the service that he renders to society. On the contrary, he expressly affirms the opposite of this in the case of the landlord, whose rent “costs him neither “labour nor care” and is “not at all proportional to what the “landlord may have laid out upon the improvement of the land, “or to what he can afford to take; but to what the farmer can “afford to give.” If at the same time, as a Moralist and

¹ *Theory of Moral Sentiments*, Pt. VI. § II. ch. iii.

² *Wealth of Nations*, Bk. I. ch. xi.

Natural Theologian, he holds that there is nothing unjust in the established order of distribution, and that each individual is duly provided for by a beneficent Providence; it is not because he considers that each enjoys wealth in proportion to his deserts, but rather because he sincerely believes in the delusiveness—so far as the individual is concerned—of the common struggle to get rich, and holds that happiness is equally distributed among the different ranks of society in spite of their vast inequalities in wealth¹.

There is therefore a great interval between the position of Adam Smith and that, for instance, of Bastiat. In Bastiat's conception of the fundamental problem of Political Economy the questions of Science and Art are completely fused; his aim being, as his biographer says, "to prove that that which is conformable to that which ought to be": and that every one gets exactly his deserts in this best of all possible economic worlds. None of the English followers of Adam Smith has ever gone so far in this direction as Bastiat; and the most eminent of them, Ricardo, represents, we may say, the opposite pole in the development of Adam Smith's doctrine. When Ricardo, using Adam Smith's term to denote a somewhat different fact, speaks of the "natural" price of labour, his phrase carries with it no optimistic or theistic suggestions whatsoever; he means simply the price which certain supposed permanent causes are continually tending to produce. Indeed he explains that "in an improving society" the market-price of labour may remain an indefinite time above the "natural" price; and he contemplates with anything but satisfaction the result of the "natural advance of society," which in his view tends to the benefit of landlords alone. He remains true, no doubt, to the "system of natural liberty" as regards the distribution of produce no less than the direction of industry; but he is further even than Adam Smith from any attempt to demonstrate a necessary harmony of interests among the producers whom he would leave to settle their shares by free contract. In fact, two of his most characteristic doctrines are diametrically opposed to any such harmony: his demonstrations, namely, that marked improvements

¹ Cf. *Theory of Moral Sentiments*, Pt. iv. ch. i. p. 419.

in agriculture have a tendency to diminish rent, and that the substitution of machinery for human labour is often very injurious to the interests of the class of labourers. And though he is averse to any direct legislative interference with the natural determination of wages, he is disposed to encourage "some effort on the part of the legislature" to secure the comforts and well-being of the poor by regulating the increase of their numbers. This last suggestion indicates a main source of the difference between Ricardo's view and that of his great predecessor. It is Malthus' Theory of Population which has rendered the optimism of the eighteenth century impossible to English economists of the nineteenth. If the tendency of Nature left alone was to produce, as the ultimate outcome of social progress, a multitude of labourers on the verge of starvation, it was difficult to contemplate her processes with anything like enthusiasm. A less "jaundiced" mind than that of the hero of *Locksley Hall* might well feel depressed at the prospect,

"Slowly comes a hungry people, as a lion creeping nigher

"Glares at one that nods and winks beside a slowly dying fire."

Hence, though English economists have, speaking broadly, adhered to Adam Smith's limitations of the sphere of government, the more thoughtful among them have enforced these limitations sadly rather than triumphantly; not as admirers of the social order at present resulting from "natural liberty," but as convinced that it was at least preferable to any artificial order that government might be able to substitute for it.

Still it remains true that English Political Economy, in whatever tone it has been expounded, has generally included an advocacy of *Laissez Faire*; and that not only in the matter of Foreign Trade, but in dealing with the deeper and more burning question of wages. Its expositors have not commonly confined themselves to tracing the laws that determine the remuneration of services, so far as it depends on free contract among persons aiming each at obtaining the greatest pecuniary gain for a given amount of effort, abstinence, or other sacrifice; but they have also, for the most part, opposed all attempts to introduce, either by law or public opinion, any different division of wealth. If they have not gone the length of maintaining that distribution by free competition is perfectly *just*, as proportion-

ing reward to service; they have still generally maintained it to be practically the best mode of dividing the produce of the organized labour of human beings; they have held that through the stimulus it gives to exertion, the self-reliance and forethought that it fosters, the free play of intellect that it allows, it must produce more happiness on the whole than any other system, in spite of the waste of the material means of happiness caused by the luxurious expenditure of the rich. Or if they have not even gone so far as this, they have at any rate taught that it is inevitable, and that any attempt to deviate from it will be merely throwing effort away. Thus, by one road or another, they have been led to the same practical conclusion in favour of non-interference; and it is hardly surprising that practical persons have mistaken this conclusion for a scientific deduction from the economic doctrines with which it was found in company, and have regarded it as a "law of political economy" that all contracts should be free and that every one should be paid exactly the market-price of his services.

It must be obvious, however, as soon as it is pointed out, that the investigation of the laws that determine actual prices, wages and profits, so far as these depend on the free competition of individuals, is essentially distinct from the question how far it is desirable that the action of free competition should be restrained or modified—whether by the steadying force of custom, the remedial intervention of philanthropy, the legislative or administrative control of government, or the voluntary combinations of masters or workmen. No doubt in order to answer this latter question satisfactorily we must ascertain the effects of these modifying causes above-mentioned—law, custom, combination and philanthropy—on the production and distribution of wealth; and to trace these effects is strictly within the province of Political Economy considered purely as a science. So far as the purely scientific economist studies primarily the results that tend to be produced by perfectly free competition, it is not because he has any predilection for this order of things—for science knows nothing of such preferences—but merely because its greater simplicity renders it easier to grasp. A knowledge of these simpler relations naturally precedes, in the order of study, the investigation

of the more complex economic problems that result from competition modified by disturbing causes¹. But as the economist's ultimate aim is to explain and predict facts, he must ultimately attack those more complex questions, if the actual condition of society presents them—just as he has always concerned himself with tracing the effects of different taxes; though in order to do this scientifically he has found it necessary to understand first the economic phenomena of a society supposed for simplicity's sake to be untaxed. In either case we shall gain in clearness by distinguishing the problems of economic science from the political or ethical problems that are commonly combined with them, and stating the former in a purely positive way; asking not "What *ought* government, or workmen, or "masters, or philanthropists to do?" but "What will be the "effects on their own wealth and that of others, if they do "so and so?" For it should always be borne in mind that the answer to this latter question can rarely furnish more than a part of the data required for answering the former; and in some cases it will not supply the most important part.

§ 4. In the preceding section I have been chiefly concerned with the Distribution of Wealth. In this part of the subject the line between Science and Art is not difficult to draw, however much the two inquiries may actually have been blended; and it has, in fact, been pretty definitely drawn by the more careful among recent writers. But the Distribution of Wealth is not, as I have said, the sole subject of economic inquiry: indeed, in the view of the English father of the science, it is not even the most prominent subject. Adam Smith's opening paragraphs represent as his main object the investigation of the conditions which determine a nation's annual supply of the necessaries and conveniences of life to be abundant or scanty. His first book begins with a discussion

¹ The statement in the text represents, I think, the general view of economists, which I am here trying to give; but it does not exactly represent my own view as regards one of these disturbing causes, viz. voluntary Combination. For Combination among the sellers of any commodity places the persons combining in a position economically similar to that of a monopolist; and though the laws that govern prices under the condition of monopoly are different from those that result from free competition, I do not perceive that they are necessarily more complex. Cf. *post*, Bk. II. c. ii.

of "the causes of the improvement in the productive powers of labour"; in his second book he is occupied in considering the fundamental importance of "stock" to production, and "the different quantities of labour which it puts in motion, according to the different ways in which it is employed." In the third he describes the diverse plans that nations have followed in the general direction of labour, with the aim of making its produce as great as possible; and, as we have seen, the "systems of political economy" discussed in his fourth book were systems framed with a view to the same end.

And most succeeding economists, though they have given continually increasing prominence to the problems of Distribution and Exchange, have followed Adam Smith so far as to assign the first place in their treatises to a Theory of Production. In this department, we have now to observe, the distinction between "what is" and "what ought to be" has always been less distinctly drawn than in that of Distribution. In the original treatment of Political Economy as an art it was always as an Art of Production rather than of Distribution that it was conceived. Indeed Adam Smith hardly considers Distribution as a practical problem; and so far as he does raise the question, how a more "liberal reward of labour" may be attained, his answer seems to be that it can only be attained by "increasing the national wealth," or in other words by solving the practical problem of Production. So again, in the brief but pregnant treatise on the Elements of Political Economy written a generation later by James Mill, it is noticeable that in describing the scope of his chapter on Production he puts prominently forward its directly practical aim: its object is, he says, to "ascertain by what means the objects of desire may be produced with the greatest ease and in greatest abundance, and upon these discoveries, when made, to form a system of rules skillfully adapted to the end." Whereas, when he comes to speak of the laws of Distribution, it never occurs to him even to hint that the process investigated admits of being improved, and that the student ought to keep this improvement in view. And in the account of the objects of Political Economy given ten years later by M^cCulloch, this difference in the treatment of the different enquiries is equally marked.

In short, we may say that from the time of Adam Smith to that of Senior and J. S. Mill the conception of Political Economy as an Art of National or Social Production had never been definitely discarded; only the main part of its practical teaching was summed up in the single negative precept of "leave alone."

But even apart from any *laissez-faire* doctrine it is easily seen that the relation between "what is" and "what ought to be" is naturally much closer in the department of Production than in that of Distribution. There is no obvious and simple connexion between an investigation of the actual facts of the division of wealth among labourers, employers, and owners of capital or land, and a discussion of the principles on which it ought to be shared among these classes; and there is no generally accepted axiom of ethics or politics which can be taken as a principle for judging of the rightness or goodness of different modes of division. In fact, we cannot consider Distribution as a practical problem without entering into the most fundamental controversies as to the ultimate basis and end of the political union. The case is quite different with Production, considered from a practical point of view. Here the obvious and uncontroverted aim of all rational effort—public or private—is, other things being the same, to produce as much as possible in proportion to the cost. The extent to which this aim is realised is the most interesting point to observe in examining the actual process of production in different ages and countries; and this is also the criterion which we adopt naturally and without reflection, when we judge different methods of production to be better or worse. Hence the transition from the point of view of Science to that of Art is, in this part of the subject, easy and almost imperceptible; the conclusions of the former are almost immediately convertible into the precepts of the latter.

Accordingly we find that even the most careful writers do not seriously attempt to keep the two points of view distinct in expounding the theory of Production. Even those who, like J. S. Mill, have taken special pains to present Political Economy as primarily a science, give a prominent place in this part of

their work to the discussion of the good and bad results of different modes of production. They analyse the gain derived from the Division of Labour, and note the counterbalancing drawbacks; they compare the advantages and disadvantages of the "grande" and "petite culture" in farming; they consider what kinds of business are adapted to management by joint-stock companies—all topics which clearly belong to the discussion of Production regarded as an Art. I am myself disposed to think that these practical questions should not be discussed at any length in an exposition of general Economic Theory; but I have found the line somewhat difficult to draw; and I certainly think that any "theory of production" which did not deal with the question "how the produce of labour "may be made as great as possible," would be meagre and uninteresting.

§ 5. At the same time, though in discussing the conditions more or less favourable to Production we inevitably approach the margin which divides Art from Science, I have thought it expedient here no less than in treating of the laws of Distribution and Exchange to keep as clear as possible of the Art of Government; even of that portion of the Art of Government which the term Political Economy was originally used to denote. Of course the separation thus aimed at cannot be made quite complete; the industrial society whose phenomena Economic Science investigates must be conceived as a governed society; and even if we reduce the functions of government to the minimum proposed by the advocates of "natural liberty," there are still many points profoundly affecting industry and trade—such as the law of inheritance, the law of bankruptcy, the law relating to patents, the management of coinage and currency, &c., &c.—on which variations in the action of civilised governments both actually exist and may be plausibly defended. This reason, among others, renders it in my opinion desirable to conform to the older and more popular view of our subject so far as to treat the principles of Governmental interference, considered in its economic aspect, as an integral part of the theory of Political Economy; but it has seemed most conducive to clearness to confine the discussion of these principles to a separate and final book on "Political Economy considered as an Art." The

Science of Political Economy, as it is ordinarily conceived in England, forms the subject of the first two books, on (1) Production and (2) Distribution and Exchange, respectively. The precise manner in which I distinguish and connect these three topics, and the grounds on which I have combined the theory of Exchange with that of Distribution, will be better explained somewhat later.

Besides the subjects above mentioned, the older economists generally introduced, as a separate department, a discussion of the laws of Consumption; and the indispensability of such a discussion has been recently urged by Professor Jevons; who goes the length of saying that "the whole theory of Economy depends upon a correct theory of Consumption." I quite agree with Mr Jevons as to the fundamental importance of certain propositions relating to Consumption; and I also think that their importance has not been adequately apprehended by many recent writers. Still, it has appeared to me most convenient, in such a treatise as the present, to introduce these propositions in discussing the questions relating to Production, Distribution and Exchange which they help to elucidate: I have therefore not thought it necessary to bring them together under a separate head.

Before concluding I may observe that the current use of the adjective "economic" affords a good illustration of what has been said above of the essential difference between Production and Distribution when considered from the point of view of Art or Practice. For when the word "economic" is used either along with such terms as "gain," "loss," "advantage," "drawback," or as a term of approval implying gain or advantage, it always refers to the relation of Cost or Expenditure to the quantity of some result attained by it. An arrangement "economically" advantageous is always one that produces the greatest possible amount of a given result at the least possible cost: there is an "economic gain" when either *cost* is saved or *produce* increased, and an "economic loss" when the reverse of either process occurs. There is no similar use of the term to imply an ideal system of distributing wealth; we should never, for instance, speak of laws relating to property as *economically* advantageous or desirable, meaning that they led to a right

division of property. We might no doubt speak of an "economic" distribution of wealth, no less than of labour; but this is really a confirmation of the view just stated; since in so speaking we should be understood to be assuming that the end of the distribution was to *produce* the greatest possible amount of happiness or satisfaction, and affirming that the arrangement spoken of as "economic" was well adapted to this end.

This peculiar use of the adjective "economic" should be carefully noticed; as it is almost indispensable, while at the same time it is a little liable to confuse the reader. The importance of exactly defining the notion conveyed by it will appear more clearly in subsequent chapters.

CHAPTER III.

METHOD OF ECONOMIC SCIENCE.

§ 1. THE result arrived at in the last chapter may be summed up thus. The Science—as distinct from the Art—of Political Economy, of which the general principles will be expounded in the first two books of this treatise, deals with the laws or general facts of the Production, Distribution, and Exchange of wealth; and also with the general facts of the Consumption of wealth, so far as these are connected with the former. This definition of the subject coincides with that adopted by most writers; but there exist considerable differences of opinion as to the method by which the subject should be investigated: differences which—as was before observed—have been brought into special prominence in recent controversies. These controversies have turned mainly on two fundamental questions, which it will be convenient to consider together, since they are closely connected. It is disputed, first, whether Political Economy can be advantageously treated separately from the general Science of Society: and secondly, whether its method is properly deductive and *à priori*, or inductive and historical.

It does not appear to me that any instructive result can be attained by discussing either of these points, unless we carefully distinguish between the different inquiries which, as we have seen, have been included under the name of Political Economy, and examine each separately in relation to the questions above raised. If we attend to this distinction I think it will appear that, though the divergences of view above noticed are likely always to exist to a certain extent, the controversy

arising from them may at any rate be reduced to a much smaller space than it at present tends to occupy.

Let us begin, then, by considering the two questions of method above mentioned in relation to the Theory of Production. The subject of this part of Political Economy may be said to be, in Adam Smith's words, "the causes of the improvement in the "productive powers of labour": or—to state it somewhat more generally—the conditions or laws by which the produce of human labour is determined to be, in a given country at a given time, greater or less than it is in other countries or at other times. I have already noticed that this question occupies generally a less prominent place in later expositions of economic doctrine than it did in earlier treatises, including the *Wealth of Nations*: and this remark applies to Mill's well-known work, if we judge by the relative space allotted to the different departments. At the same time I observe that "the question how a nation is "made wealthy" is spoken of at the outset of Mill's treatise as though it were the most obvious question that Political Economy has to answer¹; and in his preliminary definition of the scope of the Science it occupies as prominent a place as it does in that of Adam Smith. If then we ask whether the investigation of the causes, by which the labour of any society is rendered more or less productive of wealth, can be properly separated from other parts of the general science of society, it is difficult to answer such a question in an absolute way, either negatively or affirmatively: and I am not aware that any economist or sociologist of repute has so answered it. No economist, I believe, has refused to admit with Mill² "the universal consensus of social phenomena, whereby nothing which "takes place in any part of the operations of society is without "its share of influence on every other part," or, "the paramount ascendancy which the general state of civilisation and "social progress in any given society must exercise over all

¹ Cf. Mill, *Political Economy*, Preliminary Remarks, p. 2. "The inquiries "which relate to [wealth] are in no danger of being confounded with those "relating to any other of the great human interests. All know that.....the "questions *how a nation is made wealthy*, and how it is made free, or virtuous, "or eminent in literature, in the fine arts, in arms, or in polity, are totally "distinct inquiries."

² *Logic*, Bk. VI. ch. ix. § 3.

“the partial and subordinate phenomena.” Nor has any sociologist, so far as I know, denied that economic facts are to be studied separately, “just as in the natural body we study separately the physiology and pathology of each of the principal organs and tissues, though every one is acted on by the state of all the others: and though the peculiar constitution and general state of health of the organism co-operates with and often preponderates over the local causes in determining the state of any particular organ.” There may no doubt be divergences of opinion as to the precise degree in which changes in the industrial organization of society are independent of changes in other factors of social existence: but such divergences can hardly amount to a fundamental difference of method.

Nor can it be said that Mill, at any rate, merely accepts in a general phrase the interdependence of economic facts with other elements of social organization, and neglects it in detail. For instance, he continually refers to the influence exercised on the progress of industry by the constitution of the organs of Government, legislative, administrative and judicial, and their relations to the governed. In his sketch of the earlier stages of industrial development he lays great stress on this point; indeed a large portion of his introductory survey is chiefly occupied in pointing out the economic effects of Oriental despotism, of the political condition of the town-communities of modern Europe, of Roman imperialism, and of feudalism. While again, in subsequent chapters, when he is analysing the conditions on which the productiveness of labour and capital depends, he emphasizes the important influence exercised by the political constitution of the community, according to the degree of protection which this latter affords both “by the Government and against the Government”; and in several other passages he notices how the “employment of the productive resources of the country to the best advantage” is impeded by “defective institutions”—such as (e.g.) a bad poor-law, a bad system of tenancy, bad laws relating to bequest and inheritance, &c.

It is true that Mill's general treatment of the Theory of Production tacitly assumes that, in the existing stage of social

development, changes in the industrial organization of the civilised part of mankind are largely independent of changes in their political organization. But this no sociologist would deny; indeed the most obvious facts of history sufficiently prove it. For instance, in the present century, we have seen France pass from Absolute Monarchy to Limited Monarchy, from Limited Monarchy to Republic, from Republic to Empire, and from Empire to Republic again; and yet none of these changes—except the third during a transient crisis—have appreciably affected its industrial system; whereas this latter has been materially modified during the same period by causes unconnected with politics, such as the invention of railways and of electric telegraphs. At the same time I should quite admit that most English economists a generation ago hardly foresaw the extent to which political conditions would continue to affect industry up to the present date: and, similarly, the relations between the development of industry and other factors of social life, such as the progress and diffusion of knowledge, and the changes in national character or in the habits and sentiments of special classes, have hardly met with due consideration. The modifications which appear to be necessary on this score will be indicated hereafter¹; but they do not seem to me to affect the correctness of Mill's general view that the study of the industrial organization of society may be most conveniently pursued as a "separate though not independent branch of sociological speculation"—though the amount of exact general knowledge that can be attained by thus pursuing it may have been overrated.

If now we ask whether the method of such an investigation as we have been considering should be 'inductive' and 'historical' or 'deductive' and 'à priori,' it again seems to me clear that there is not really room for much controversy. At any rate, I know of no economist who has attempted to ascertain the "causes of the improvement in the productive powers of labour" by a method purely—or even mainly—*à priori* and unhistorical. A certain amount of deductive reasoning, no doubt, has commonly been introduced into this investigation: but this seems inevitable. In particular, we require for the comprehension of

¹ Cf. esp. Bk. II. ch. 6.

economic facts some interpretation of the motives of human agents; and this has necessarily to be supplied, to a large extent, from our general knowledge¹ of human nature—modified, of course, by any special knowledge that we may be able to gain as to the peculiar mental characteristics of the class of persons whom we are considering. But in the general analysis of the conditions favourable to effective production, which Mill and other writers who have followed him have given in the first part of their exposition, the deductive element has always been quite subordinate; and so far as the method adopted is different from what would ordinarily be called ‘inductive,’ it is not because it is in any sense an *à priori* method; but because it chiefly consists in getting a clearer and more systematic view, through reflective analysis, of general facts which common experience has already made familiar.

To illustrate this, let us examine briefly the particulars of Mill's exposition. In the first six chapters he states the requisites of production, labour, capital and natural agents: he defines the notion of labour, considers its relation to the natural agents on which it operates, and classifies the different kinds of labour and the different species of utility produced by it; he makes clear the notion of capital, as wealth diverted from the purpose of directly satisfying its owner's needs, and employed, whether in the form of instruments or labourers' necessaries, in producing other wealth: he points out how capital is continually consumed and reproduced, but with various degrees of rapidity, according as it is fixed or circulating. It is obvious that all these results, however interesting, are obtained by merely analysing and systematizing our common empirical knowledge of the facts of industry. No doubt in discussing the well-known propositions that “demand for commodities is not “demand for labour” and that “increase of fixed capital may be “detrimental to labourers,” some difficult deduction is intro-

¹ How far this general knowledge is itself acquired by induction of some sort is not, of course, the question. As Mill explains, in the passage referred to in the next note, the economic “method *à priori*” is not a “mode of philosophizing “which does not profess to be founded on experience at all”; but is merely distinguished from the “method *à posteriori*” by not requiring, as the basis of its conclusions, *specific* experience of economic facts.

duced. But these propositions belong rather to the Theory of Distribution than to that of Production; and at any rate help us very little towards the required "explanation of the diversities of riches and poverty in the present and past, and of "whatever increase is reserved for the future." For this explanation we have to consider the conditions on which the degree of productiveness of different productive agents depends: and it does not seem possible to obtain an adequate view of these conditions, without more or less careful induction. Certainly when in Ch. VII. Mill goes on to discuss this, his method is again merely that of comparing and generalising from observed facts. Thus he studies quite *à posteriori* the differences in the natural advantages of different countries; the differences among human beings in habits of energetic work, in capacity of exertion for distant objects, in keenness of desire for wealth, and in other intellectual and moral qualities; finally—as was before noticed—the differences in the security afforded "by government, and against government." So further, in the discussion of the advantages of division of labour, and in the comparison of production on a small scale with production on a large scale, his argument though partly deductive still relies greatly on specific experience. Then again, when he states the law of the increase of labour, the causes that actually counteract the capacity of increasing population inherent in human beings, and the extent of their operation, are all ascertained inductively (Ch. X.); and so of course are the actual variations in the "effective desire "of accumulation," which causes the increase of capital (Ch. XI.). In both these cases we could, no doubt, without conscious induction, lay down certain incontrovertible abstract propositions; but in the former case we should hardly get beyond the truths of elementary arithmetic, and in the latter case we should hardly get beyond such trivial maxims as that "wealth is increased by industry and thrift," &c.

I have gone into these details, not because I wish to lay stress on Mill's authority, but because none of the "orthodox" critics of his widely-read book has ever attacked his general method of treating the Theory of Production. What therefore we have to remark is not merely that Mill's treatment of this

part of his subject is mainly inductive and analytical; but that it never seems to have occurred to any "à priori" economist that it ought to have been different.

§ 2. Why then, it may be pertinently asked, does Mill say—as he certainly does say¹—that Political Economy is essentially an abstract science, that its method is essentially "the method *à priori*," and that it "has been so understood and taught by all "its most distinguished teachers"? The only answer I can give is that in this and similar passages Mill is thinking, not of the Theory of Production as he himself conceives and expounds it, but of the Theory of Distribution and Exchange: and primarily of that portion of this latter subject which he distinguishes as "statical" and not "dynamical"²—i.e. that which treats of the determination of the reward of services and the value of products in the existing condition of industry. This is the part of the subject to which, since Ricardo, the attention of economic theorists has been chiefly directed (though they have often not distinguished it clearly from other parts): and it is easy to show how a method largely different from that adopted in treating the question of production naturally suggests itself here. The broad and striking fact which originally led and still leads reflective minds to discuss the question "how a nation is made wealthy" is the vast difference between the amounts of wealth possessed by different nations and by the same nation at different periods of its history; especially the great increase in the most recent times, in consequence of what we speak of vaguely as "advance of civilisation," "progress of arts and sciences," "development of trade and commerce," &c. Hence our study in this department almost inevitably takes an inductive and historical form; becomes, we may say, a study of Comparative Plutology. And of course we may examine the phenomena of distribution from the same point of view; we may ask why the share of wealth annually obtained by an

¹ See in particular the Essay "On the Definition and Method of Political Economy," in his *Essays on some unsettled Questions in Political Economy*. The doctrine here laid down is also maintained in his *Logic*, B. VI. c. IX. § 3; where a long quotation from this essay is introduced.

² I ought perhaps to say that I do not regard as satisfactory either the line that Mill draws by means of this pair of terms, or his manner of treating the questions that he distinguishes as "dynamical."

English miner is larger than that obtained by a German miner, or why an English landlord now obtains higher rents than he did 100 years ago. But if we ask questions of this kind, and if in our answers we—to use Mill's phrase—"include directly or remotely, the operation of all the causes" that have combined in causing the differences investigated, it seems evident that our method of investigation must be, what we have seen it to be by common consent in dealing with the theory of production, a mainly inductive and historical one. We shall have to note and explain differences and changes in national character generally, in the habitual energy, enterprise, and thrift of special classes, in law and administration and other political circumstances, in the state of knowledge, the state of general and special education, and other social facts; and in this explanation the "method *à priori*" can evidently occupy but a very subordinate place.

But such questions are not, I think, those which most obviously suggest themselves in connexion with the phenomena of distribution. Here the broad and striking fact, that at once troubles the sympathy and stirs the curiosity of reflective persons, is the great difference between the shares of different members of the same society at the same time. Thus what economists have been primarily concerned to explain is how the complicated division of the produce of industry among the different classes of persons who have co-operated to produce it is actually determined here and now; and what is likely to be the effect of any particular change that may occur in the determining conditions, while the general state of things remains substantially the same. Similarly as regards the phenomena of exchange, the most natural and obvious question is why each of the vast number of articles that make up what in the aggregate we call wealth is exchanged and estimated at its present price; and how far any particular event, other things remaining the same, would tend to raise or lower its price.

It is in answering these questions that the general theory of Political Economy, as commonly treated, uses mainly an abstract, deductive, and hypothetical method. That is, it considers the general laws governing the determination of remunerations and prices, in a state of things taken as the type to which modern

civilised society generally approximates, in which freedom of exchange and freedom in choice of calling and domicile are supposed to be—broadly speaking—complete within a certain range, and in which the natures and relations of the human beings composing the industrial organization are supposed to be simpler and more uniform than is actually the case in any known community. By means of this simplification we obtain exact answers to our general economic questions through reasonings that sometimes reach a considerable degree of complexity. It is obvious that answers so obtained do not by themselves enable us accurately to interpret or predict concrete economic phenomena; but it is commonly held that when modified by a rough conjectural allowance for the difference between our hypothetical premises and the actual facts in any case, they do materially assist us in attaining approximate correctness in our interpretations and predictions.

I do not here profess to discuss how far experience has shown such deductions to be applicable and useful. But it seems evident that their applicability and utility will depend largely on two conditions: first on the degree of success attained in forming our original suppositions, so that they may correspond as closely as possible to the facts, without becoming unmanageably complex; and secondly on the extent to which we recognise and attend to the divergence from facts which is—in most cases—inevitable in such abstract reasonings, and the insight and skill which we show in conjecturing roughly the effect of modifying causes whose operation we cannot precisely trace. To secure success in either of these respects we require an accurate knowledge of the general characteristics of the matter with which we are dealing; and I do not see how we are to obtain this knowledge without an inductive study of economic facts. It is not perhaps necessary that the deductive and inductive investigation of any class of economic phenomena should be carried on simultaneously, or even by the same persons; but at any rate the latter would seem to be an indispensable supplement to the former.

§ 3. To illustrate the necessary place of Induction even in connexion with the ordinary reasonings of the deductive Political Economy, it may be convenient to examine briefly the funda-

mental assumptions of the latter. The first and most fundamental is, that all persons engaged in industry will, in selling or lending goods or contracting to render services, endeavour *ceteris paribus* to get as much wealth as they can in return for the commodity they offer. This is often more briefly expressed by saying that Political Economy assumes the universality and unlimitedness of the desire for wealth. Against this assumption it has been urged that men do not, for the most part, desire wealth in general, but this or that particular kind of wealth: in fact, that "the desire of wealth is an abstraction, "confounding a great variety of different and heterogeneous "motives which have been mistaken for a single homogeneous "force¹." It does not, however, appear that there is necessarily any such mistake as Mr Cliffe Leslie supposes. For so far as the objects of these different and heterogeneous desires are all exchangeable and commensurable in value, they all admit of being regarded as definite quantities of one thing—wealth; and it is just because the "desire of wealth" may, for this reason, be used to include "all the needs, appetites, passions, tastes, "aims, and ideas which the various things comprehended under "the word wealth satisfy," that we are able to assume, to the extent required in deductive political economy, its practical universality and unlimitedness. There is no particular species of wealth of which it would be approximately true to say that every one desires as much of it as he can get. But there is no class of persons engaged in industry of whom it cannot be said with approximate truth that they would always like more of some kind of wealth if they could get it without the least sacrifice. Even the richest capitalists and landowners, who are merely connected with industry as lenders of wealth, are found to have a desire of wealth sufficiently strong to prevent them from letting indifferent persons have the use of their property at less than the market rate.

At the same time it is equally true that there are other things obtainable by labour, besides wealth, which mankind generally, if not universally, desire; such as power, and reputation: and it is further undeniable that men are largely induced to render services of various kinds by family affection, friend-

¹ *Essays in Political and Moral Philosophy*, p. 233.

ship, compassion, national and local patriotism and other kinds of *esprit de corps*, and other motives. The amount of unpaid work that is done from such motives, in modern civilised society, forms a substantial part of the whole: and political economists are perhaps fairly chargeable with an omission in making no express reference to such work—with the exception of the mutual services rendered by husbands and wives, and by parents and children. It is however to be said that services altogether unremunerated by money occupy no important place in the organization of industry; they belong chiefly to the exercise of governmental or literary functions, or the management of property (trust-funds), or to some part of that complex system of eleemosynary labour and expenditure, which actually supplements the deficiencies of the industrial distribution. And so far as paid services are concerned, all economists, from Adam Smith downwards, have recognised the operation of other motives—as for instance the love of reputation—as a cause of the difference of remuneration in different employments. All therefore that they have explicitly assumed is that, *other things being equal*, a man will prefer a larger price or remuneration to a smaller. This qualification includes, of course, disagreeable things that have to be borne, as well as desirable things that may be acquired; indeed Adam Smith draws express attention to the differences in the agreeableness and disagreeableness of different employments as a cause of diversity in wages.

Among the disagreeable things that have to be borne Labour itself generally occupies a prominent place, in the view of the deductive economists. Mill, for instance, speaks of “aversion to labour” as a “perpetually antagonizing principle” to the desire of wealth: and it has been customary to attribute to it an equal degree of universality; it being affirmed not merely that “every one desires to obtain as much wealth as possible,” but that he also desires to obtain it by “the least possible amount of labour.” This proposition, however, is open to the obvious objection that many persons get more happiness out of their work than they do out of a good deal of their expenditure. And it appears to me that it is quite unnecessary, in ordinary economic reasonings on problems of distribution, to assume that mankind are generally “averse to labour.” The assumption really

required is merely that every man will require payment for his work if he can get it; but this immediately follows from the desire of wealth, if there is no special and adequate motive for the gratuitous performance of the work; since the fact that a man likes his work is not a reason why he should consent to do it for nothing, if he can get something by his labour, and if he has a desire of that something¹.

There is no doubt an important position, commonly maintained by economists, in support of which the assumption of a widespread "aversion to labour" is useful if not indispensable: namely the justification, as against communism, of the existing individualistic organization of industry. For the purposes of this argument it is clearly important to show that men in general would not work without the powerful motive supplied by their desire of wealth for themselves and their families. And certainly we seem able to infer, from observation of the manner in which even the respectable rich employ their time, that no important part of the labour required for the production of wealth is likely to be carried on to an adequate extent, with adequate perseverance throughout the day and from day to day, by such beings as men now are, except under the influence of some motive more powerful than an average man's liking for work. Whether any communistic scheme can be expected to supply such motives adequately is a question which we may afterwards take occasion to discuss. Meanwhile, for ordinary economic reasonings, we may accept the proposition "that every one desires as much wealth as "possible at the least possible sacrifice," without necessarily adding that he always regards the mere labour as a sacrifice.

¹ It may perhaps be urged that labour, though not necessarily on the whole disagreeable, must have begun to have this quality at the point at which the labourer leaves off; since otherwise he would not leave off, provided he could obtain anything desired by continuing to work. But the argument is not conclusive. A man may cease to labour merely (1) because, without disliking his work, he prefers leisure to the additional wealth he could earn by additional labour; or (2) because it would be bad economy of his powers to continue, since additional work to-day would cause a more than proportionate decrease in efficiency for work hereafter. I suppose that one or other—or both—of these two explanations would be generally true, as regards the higher kinds of intellectual work.

From this fundamental assumption we may immediately infer, that so far as freedom of contract exists, similar exchanges will be made on approximately similar terms, at least within the limits of the same market; meaning by a market¹ a body of persons in such commercial relations that each can easily acquaint himself with the rates at which certain kinds of exchanges of goods or services are from time to time made by the others. For it is obvious that, if A prefers a greater gain to a smaller, he will not sell his goods or his services to B at a rate lower than what he thinks he could obtain elsewhere; allowance being made for any trouble, expense, or other sacrifice that he would incur in getting the more favourable terms. This inference is often broadly expressed by the statement that "where there is open competition, there cannot be two prices "in one market for the same commodity." Such a statement, as ordinarily understood, implies that the market-price is determined by the unconcerted action of individual exchangers. We have, however, no ground for assuming *à priori* that the uncontrolled action of enlightened persons seeking each his own greatest pecuniary gain may not under certain circumstances result in a deliberate combination of sellers or buyers to dictate terms of exchange. And I shall afterwards show that the question what price enlightened self-interest will prompt such a combined body to demand is not outside the range of the deductive method; it is only a special case of the determination of the value of a monopolized article, which may be made the subject of abstract reasoning as suitably as any other determination of value. But it is convenient and customary to use the term 'competition' to imply the absence of such combination; and I shall so use it.

The operation of competition above described, by which the terms of *similar* exchanges are kept approximately similar, should be carefully distinguished from that other action of competition, by which certain inequalities in the remuneration of *dissimilar* services tend to be continually removed, though more slowly and indirectly. In this latter case we have to consider the influence exercised by the desire of wealth

¹ Cf. Jevons, *Theory of Political Economy*, c. iv. "Definition of a market."

and the knowledge of current rates of remuneration not on the terms of particular bargains, but on men's choice of—or adhesion to—their respective trades or professions. The existence of this influence may be inferred from the assumptions already made as immediately and cogently as the influence of competition on similar exchanges. That is, we may infer that persons considering what trade or profession to select among those open to them will, other things being equal, select those that they (or their advisers) believe to be best remunerated; and further that persons will leave a badly remunerated trade when they think that they can obtain elsewhere a remuneration sufficiently higher to compensate for the trouble and annoyance—and in most cases extra risk—involved in the change.

To complete our list of the assumptions ordinarily made by English political economists we should have to include other propositions relating to several different social facts, such as Population, Agriculture and Government. But the principles of competition above given are certainly the chief and cardinal axioms of deductive economics: and perhaps they will serve for our present purpose. As I have stated them, they seem to me incontrovertibly legitimate. But I see no adequate ground for assuming them *à priori*, *except* with the qualifications above given; and as so qualified, they are incapable of being applied to explain or predict the economic phenomena of any actual society without additional data, which can only be obtained by a careful study of facts. We may affirm *à priori* that men will prefer a greater gain to a less, *other things being equal*; but we can draw no positive inferences from this without ascertaining how far other things are equal: and we can only learn by careful induction the force of the other motives, of which all economists admit the existence and importance; especially of the powerful but unobtrusive impulses which lead a man to do what other people do, and what he himself has done before. Similarly we may affirm that in a perfectly organized market, in which the terms of all bargains may be ascertained without more trouble than average exchangers are able and willing to take, the price of similar commodities will be approximately the same, allowance being made for the trouble and expense of conveying the commodity; but we can only learn by a

study of facts how far in any given society at any given time the conditions of sale of any particular commodity approximate to those of a perfectly organized market. With what degree of precision the required knowledge can be obtained, what exertions, intellectual or physical, are needed to obtain it, what the probability is of these exertions being made by average sellers or buyers of the commodity in question, are all points that can only be determined by induction. So again, it may be granted that competition tends to equalise the remunerations, so far as they are known, of dissimilar services, involving equal sacrifices and rendered by persons with equal natural qualifications and opportunities. But before we can apply this principle in any concrete case, we have obviously to ascertain how the different persons or classes of persons concerned estimate particular sacrifices, and what their qualifications and opportunities are; that is, to what extent, and by what expenditure of time and means, they are really able to fit themselves for each of the different careers that they are legally free to enter.

§ 4. These limitations to the use of the deductive method in Political Economy appear to me obvious and incontrovertible. I must admit, however, that they have not always been duly recognised by deductive economists; who have in consequence been led to make somewhat too sweeping assertions as to concrete facts. I think that writers of the opposite school have done good service in criticizing these assertions, and the confident and dogmatic tone in which they have been enunciated. But I cannot accept the conclusion which some of them have proceeded to draw, that the traditional method of English Political Economy is essentially faulty and misleading. I quite admit that the direct utility of the deductive method, as a means of interpreting and explaining concrete facts—though not its validity, so long as it is regarded as merely abstract and hypothetical—depends on its being used with as full knowledge as possible of the results of observation and induction. But its indirect utility, as a means of training the intellect in the *kind* of reasoning required for dealing with concrete economic problems, depends to a far less degree on such empirical knowledge; and I cannot see that this indirect utility is materially affected

by any divergences that have been shown to exist between the premises of current deductions and the actual facts of industry. On the other hand, I think that both the validity and the utility of the current deductions have been somewhat impaired by a want of thorough explicitness as to the assumptions on which these reasonings depend, and by a want of clearness in the cardinal notions employed in them. In order to guard against this latter defect, I have been led to perform with rather unusual elaborateness the task of defining the cardinal terms of Political Economy. The precise advantages that I have hoped to gain by this are explained in the second chapter of the following book, in which the task is commenced: I trust that I shall convince the reader that the process, however tedious, is absolutely indispensable to that exact treatment of economic questions, to which alone the epithet 'scientific' ought to be applied.

Here I may notice the discussion that has recently been raised¹ on an issue still wider than that debated between the advocates of the "à priori" economics, and the Inductive or "realistic" school; viz. on the pretensions of Political Economy to be a science at all. I certainly think the language sometimes used by economic writers, suggesting as it does that the doctrines they expound are entitled in respect of scientific perfection to rank with those of Physics, is liable to be seriously misleading. But I am not disposed to infer from this that we ought to follow the precepts—and example—of Professor Price in treating Political Economy unscientifically². My inference would rather be, not that we ought not to aim at being as scientific as we can, but that we ought to take care not to deceive ourselves as to the extent to which we have actually attained our aim: that, for instance, so far as we are treating Political Economy positively, we should avoid mistaking a generalisation from limited experience for a universal law; and so far as we are treating it hypothetically, we should take care

¹ See especially Professor Price's *Practical Political Economy*.

² I cannot but observe that Mr Price has avoided scientific precision in his criticisms of his predecessors no less than in his own reasonings. Some of his polemical references to Mill's book contain the most random misrepresentations of that author's meaning that I have yet met with—which is saying a great deal.

not to use words in different meanings without being aware of the difference, nor suppose our notions to be quantitatively precise when they are really indefinite. The endeavour to be scientific in this sense will not lead to hasty and mistaken dogmatism; on the contrary, it will, I hope, deliver us from the hasty and mistaken dogmatism, caused by loose and confused thinking, to which 'common sense' or 'natural intelligence' is always liable.

At the same time I do not mean to imply that economic theory ought always to be expounded with scientific exactness; any more than I would affirm that the topics of distribution and exchange must necessarily be treated in an abstract and hypothetical manner. I certainly hold that very few general statements, aiming at quantitative precision, can be safely made without careful definitions; and that very few reasonings of the same kind can dispense with assumptions which ought to be stated as explicitly as possible. But much useful instruction may be given by what might be called merely *qualitative analysis* of economic phenomena. The discussion of the conditions of production in Ch. III. of the following book is intended to give the results of this kind of analysis.

BOOK I.

CHAPTER I.

THE THEORY OF PRODUCTION.

§ 1. THE fundamental question with which we shall be concerned in the present Book may be simply stated thus: Under what conditions, or by the operation of what laws, does a nation become more or less wealthy? The need of a more precise definition of this question, and the proper mode of meeting this need, will be explained as we go on; at the outset this more obvious and popular statement seems sufficient.

In considering this question the first point which presents itself is the difficulty of separating the study of Production from the study of Distribution and Exchange. It is easily seen that the kinds of wealth produced in any society depend largely on the manner in which wealth is distributed among the members of the society. In a community where there is a large middle class, there will probably be an abundance of cheap luxuries; while where there are only a few rich persons among a multitude of poor, we shall expect to find a production mainly of necessaries, with a small amount of costly and elaborate commodities. Similarly, Distribution cannot fail to influence the *amounts* of wealth produced; since both the nature and the intensity of the motives, that normally prompt men either to labour or to save, vary considerably according to their position in the scale of wealth and poverty. The precise importance of the influence thus exercised on production is no doubt hard to estimate. Indeed if we were able to estimate it exactly,—if (e.g.) we could tell how far the improvement in industrial instruments and processes would go on as at present, if the inventors and managers of industry had not the

present keen spur of private gain—the controversy between Socialists and advocates of *laissez-faire* would be much nearer settlement than it is. But however we may answer such questions as this, we are equally bound to take note of the effects of the existing distribution of wealth; as supplying to the different classes engaged in production the stimulus that actually prompts the energetic and sustained labour, and the extensive outlay of wealth for remote results, which we find them undertaking.

None the less does it seem to me desirable that we should practise ourselves in contemplating the process of production from the point of view of society as a whole, abstracting as far as possible from the ‘adjustment of the terms of co-operation’¹ among producers; so that the total gain or loss in wealth resulting from any given change to the aggregate of human beings concerned may be habitually distinguished from those gains and losses of individuals which, regarded from the point of view of society, are mere transfers. To mistake the latter kind of effect for the former is one of the commonest errors of popular economic discussion; the effect of a new law, a tax, a war, or other important social event, on some particular class of persons, being specially striking and impressive, attracts the attention of ordinary observers to the exclusion of all other effects. Again, many of the cardinal notions of Political Economy, such as Capital, Profit, Cost of Production—even the more elementary notion of Wealth—are naturally conceived somewhat differently from the point of view of the individual and from that of society; and it is important to recognise clearly this doubleness of meaning, so as to guard against the confusions that are liable to arise out of it.

Accordingly I propose in the present Book, to keep as consistently as possible to the social view of industry. We shall consider the members of the human family as combining, on certain terms, the determination of which we do not at present investigate, in the work of adapting their material environment to their joint needs and uses; we shall examine the circumstances

¹ The phrase is quoted from Hearn’s *Plutology*. I take this opportunity of acknowledging the assistance that I have derived from this well-written and instructive work, in composing this part of my treatise.

that have been favourable or adverse to this combined operation, and try to forecast, so far as may be, the prospect of greater or less success in it hereafter. We must take notice of variations in the amounts of the products of industry, falling to the lot respectively of the different classes of persons who have combined, personally or by lending their property, to produce them; indeed we shall have to consider these varying shares from two distinct points of view, both as motives to labour and saving, and as means to the efficient performance of functions: but we shall not inquire how the amount of each share comes to be neither more nor less than it is.

§ 2. But though I thus agree with Mill in separating the Theory of Production from that of Distribution and Exchange, I cannot agree with him in separating the discussion of the fundamental notions employed in the former from the discussion of Exchange Value. No doubt much useful instruction may be given, as to the conditions of increase or decrease of wealth, greater or less efficiency of production, without entering on the discussion of value. But it is impossible to form any precise idea of amounts of wealth, before we have exactly determined the manner in which wealth is to be measured; and since wealth is popularly measured by its price—that is, its money value—we cannot establish a scientific method of measuring it without a complete discussion of the difficulties that meet us when we try to get a perfectly precise notion of Value. A scientific treatment, therefore, of the Theory of Production must begin with a systematic attempt to define the notions of Value and Wealth. This attempt will occupy the two following chapters. In the third chapter I shall proceed to what I have called a ‘qualitative analysis’ of the conditions of Production; in the course of which the relation of Capital to other factors of industrial progress will naturally be indicated. But to make this relation quite clear, it will be necessary to take up again the task of definition and affix a precise meaning to the term Capital. Then in a concluding chapter I shall examine how far we can determine the general laws of operation of the causes on which the increase or decrease of wealth in any society has been found to depend.

CHAPTER II.

THE DEFINITION AND MEASURE OF VALUE.

§ 1. BEFORE attempting to make the common notion of value clear and quantitatively precise, it may be useful to explain my general view of the work of definition, which will occupy so large a space in this part of my treatise. For, in spite of all that has been written, by authors of deserved repute, on the place of Definition in Economic Science, it still seems to me that this introductory part of the study is rarely treated from such a point of view as would enable us to derive the maximum of instruction from it. The economists who have given most attention to the matter seem to me commonly to fall into two opposite errors at the same time. They underrate the importance of *seeking* for the best definition of each cardinal term, and they overrate the importance of *finding* it. The truth is,—as most readers of Plato know, only it is a truth difficult to retain and apply,—that what we gain by discussing a definition is often but slightly represented in the superior fitness of the formula that we ultimately adopt; it consists chiefly in the greater clearness and fulness in which the characteristics of the matter to which the formula refers have been brought before the mind in the process of seeking for it. While we are apparently aiming at definitions of terms, our attention should be really fixed on distinctions and relations of fact. These latter are what we are concerned to know, contemplate, and as far as possible arrange and systematize; and in subjects where we cannot present them to the mind in orderly fulness by the exercise of the organs of sense, there is no way of surveying them so convenient as that of reflecting on

our use of common terms. And this reflective contemplation is naturally stimulated by the effort to define; but when the process has been fully performed, when the distinctions and relations of fact have been clearly apprehended, the final question as to the mode in which they should be represented in a definition is really—what the whole discussion appears to superficial readers—a question about words alone. Hence in comparing different definitions our aim should be far less to decide which we ought to adopt, than to apprehend and duly consider the grounds on which each has commended itself to reflective minds. We shall generally find that each writer has noted some relation, some resemblance or difference, which others have overlooked; and we shall gain in completeness, and often in precision, of view by following him in his observations, whether or not we follow him in his conclusions. I may observe that there is a natural tendency to estimate the results of intellectual, as of other, labour in proportion to their cost; hence the more difficulty we have found in drawing a line of definition, the more inclined we are to emphasize its importance when once drawn, and to overlook or underrate the points of resemblance which objects excluded by it have to those included. Whereas the very difficulty of drawing the line is most likely due to the importance of these points of resemblance; and instead of forgetting them when the work of definition has been performed to our satisfaction, we ought to take special pains to keep them before our minds.

I have said that in the work of definition, the final question—the point which we directly raise and settle—must be merely a question as to the use of words. In saying this I do not at all mean to depreciate its importance, or to justify a careless treatment of it. No doubt if our view of the subject is tolerably complete, and our notions clear and precise, it is of secondary importance what verbal tools we use in reasoning, so long as we use them consistently; but this secondary importance is sufficiently great to claim our most careful consideration. There seem to be two conditions which it is on different grounds desirable that a definition should satisfy as far as possible; but we should bear in mind that we frequently cannot completely

satisfy either—still less both together. In the first place, we should keep as closely as we can to the common use of language: otherwise we are not only exposed to the danger of being misunderstood by others, through the force of habitual usage overcoming the impression produced by express definition; but we further run serious risk of being inconsistent with ourselves, on account of the similar effect of habit on our own minds. Secondly, our definitions should be carefully adapted to the doctrine that we have to expound; so that we may avoid as far as possible the continual use of qualifying epithets and phrases. In aiming at the first of these results, we should not forget that common usage may be inconsistent; on the other hand, we should not hastily assume that this is the case. Economists have sometimes missed the useful lessons which common thought has to teach, by deciding prematurely that a word is used in two or more distinct senses, and thus omitting to notice the common link of meaning that connects them. Still, it will of course often happen that we cannot fit a word for scientific use without cutting off some part of its ordinary signification: hence it is very important that we should keep carefully distinct the two very different questions (1) What *do* we commonly mean by the terms, Value, Wealth, Capital, Money, &c.? and (2) What *ought* we to mean by them—what meaning is it, for scientific purposes, convenient to attach to them? I think that a good deal of unnecessary controversy has been due to a want of clear separation between these two very different inquiries, and the different methods of discussion respectively appropriate to them. It seems to be forgotten that the former question is not strictly an economic question at all, but a linguistic one; we may even add that it is a linguistic question which those who are most acquainted with economic facts find themselves least able to solve succinctly and satisfactorily: since in attempting to give to common terms the precision which their own view of the facts requires, they inevitably raise questions which are not raised in ordinary thought, and to which therefore it is illusory to suppose that common usage gives even an implicit answer. Again, in trying to adapt our terms to scientific purposes, we must remember that, dealing as we are with facts whose relations of resemblance and

difference are highly complex, we may often require to classify them somewhat differently for the purposes of different inquiries; and that hence a definition which would be most suitable for one investigation will require some modification to render it convenient for another. Economists have frequently found this; and have been content to meet the difficulty by using the same word with slight differences of meaning. This seems to me often the best course to adopt, provided the change is clearly stated and kept before the reader's mind. I find, however, that even careful writers have been too much inclined to slur over the differences of meaning, and keep them in the background, especially when they are not considerable in amount: a procedure which dangerously tends to encourage looseness of thought.

I have spoken once or twice of the importance of making our thought precise. I do not mean that we should necessarily aim at quantitative exactness in all our statements of economic laws. I quite agree with the writers (such as Cairnes) who have warned us against the futility of such an aim. But the more inevitable it is that our conclusions should be merely rough and approximate, the more important it becomes that we should be thoroughly aware when and how far they are wanting in exactness; and in order that we may be aware of this, we should make our *conceptions* as precise as possible, even when we cannot make our *statements* so. Only in this way can we keep before our minds the inadequacy of our knowledge of particulars to supply answers to the questions which our general notions lead us to ask. And if, as is sometimes the case, even our general conceptions cannot be reduced to perfect exactness; it is still desirable that we should know why this is the case, and what obstacles the fact presents to our efforts to think precisely about it. This precaution seems to me to have been specially neglected by economists. Most of the objects about which they reason are conceived as possessing definite quantity. Yet (e.g.) some of the most eminent of them¹ have not always seen that it is impossible to think definitely of the quantity of any aggregate of diverse elements, except so far as these elements admit of being reduced to a common quantitative standard; and that unless this is done, when we speak of such

¹ Cf. post, B. II. c. II.

an aggregate as having increased or decreased in amount, or of something else as "varying in proportion to" it, we are using words to which there are necessarily no definite thoughts corresponding.

Bearing in mind then these general considerations, let us attempt to deal with the much controverted notion of Value upon the principles above laid down¹.

§ 2. The first point to observe is that economists have usually followed the Physiocrats in noticing an "obvious ambiguity in the term value;" which—I am quoting from Mill²—"in one of its senses signifies usefulness, in another, power of purchasing;" or, in Adam Smith's language, Value in use and Value in exchange. Mill goes on to explain that value in use is the extreme limit of value in exchange: but he does not expressly try to explain the ambiguity that he points out; he does not ask himself why the term value should have in common usage two meanings so apparently distinct as usefulness and power of purchasing. And yet the answer is not only obvious³, but it gives an insight into the meaning of Exchange Value, which might have saved Ricardo and others from serious errors: in fact, this is a case in which economists have missed important instruction by paying too little deference to common thought. What do we mean when we speak of a man setting value on, or attaching value to, things to which the idea of exchange is inapplicable—whether this inapplicability be due to circumstances isolating the man, as, for instance, if we think of Robinson Crusoe on his island; or to the fact that no one else would buy the things, as in the case of old letters and other memorials, knowledge of various kinds, &c.? We do not, I think, mean exactly that the things are useful to him; though no doubt they *are* in a certain sense useful, that is, they

¹ I may observe that there is some dispute as to which is the most fundamental conception of Political Economy. Some writers hold that it is Value; while the received view in England is that it is Wealth. Since, however, it is also the received view in England that Wealth should be defined by the characteristic of possessing Value, it seems in any case the most logical course to begin by attempting to get a precise conception of this characteristic.

² *Political Economy*, III. c. i. § 2.

³ It is implicitly given by Mill in the passage from which I have quoted; but he fails to see the full bearing of his own statements.

satisfy or prevent some desire which is or would be felt in the absence of them¹. But we mean that the man would, if necessary, *give something* to gain or keep them. This something may be some useful material thing, or it may be labour of some kind; the general notion of value leaves this quite indefinite, provided only the giving of the matter or labour would not occur unless there were something to be got or kept by it. All that it distinctly involves is the notion of something else, presented as a possible alternative for the thing valued.

If this, then, be the fundamental conception of Value when exchange is out of the question, it does not seem to be essentially altered in the more ordinary case when, in speaking of the value of a thing, we no doubt have in view its Exchange Value. Only in this latter case we mean that *other people* would give something for the article in question: that it could be sold for something in open market. If we only wanted a *qualitative* definition of the common notion of value, we need not press our inquiries beyond this; we need not go on to ask *what* it is that other people would give in exchange. But if we use the notion *quantitatively*, as we commonly do, and as we require to do for the purposes of economic science; if we think of a thing A as having *more* or *less* value than a thing B, we must mean that purchasers in general will give for A more or less of the same kind of thing that they are supposed to give for B. That is, we require a Standard of Value. And further,

¹ This seems to be the meaning of the terms "useful," "utility," &c., in economic discussions. It is not, I think, quite convenient to say with Professor Jevons that 'useful' is that which gives pleasure; and to measure 'utility,' in the Benthamite way, by the balance of pleasurable over painful consequences. For *primâ facie* there are many valued things—alcohol, opium, &c.—which not only have an actual tendency to produce a balance of painful consequences to their consumers, but are even known to have this tendency by the persons who nevertheless value and consume them. And, as economists, we are not concerned with these painful consequences—except, indeed, so far as they impair the efficiency of the persons on whom they fall—what we are concerned with, is the intensity of the desire or demand for the articles in question, as measured by the amount of other things, or of labour, that their consumers are prepared to give for them. Hence it would be clearer to employ some other word for what is now called "utility;" but the latter word is now so firmly established in economic exposition, that it seems best to retain it, with the explanation above given.

if we make our quantitative comparison precise, and think of one thing as being (e.g.) *twice* as valuable as another, we necessarily imply what economists call a "perfect market," in which there cannot be two prices for the same thing at the same time. So long as this market is thought of at a particular place and time, the conception of a standard of value presents no difficulty. Obviously, any thing we choose will serve for a standard; for if cloth (e.g.) will sell in a perfect market for more of any one thing than linen will, it will sell for more of any other thing.

But a perplexity arises when we compare the values of the same thing at different times, and speak of things increasing or decreasing in value. For here we can no longer take anything we like as a standard of value; since we do not think a thing more valuable because it will sell for more of something that has grown cheaper. When therefore we say that a thing has risen in value, what do we exactly mean? To this question one of two answers is commonly given; either (1) that the thing would sell for more of things in general, or (2) that it would sell for more of something which itself had not varied in value. Neither of these answers is altogether satisfactory. The first is at once abstract and vague; we cannot actually exchange an article for 'things in general;' and it is not easy to see how we can state its value in terms of such an aggregate, if the elements composing the aggregate have in the mean time varied in value relatively to each other, as may easily be the case. The second answer appears to avoid this difficulty; but this appearance is soon dispelled. For reflection shows us that the notion of '*not* varying in value' must be exactly as hard to define as the opposite notion of '*varying* in value.' The second answer, therefore, still leaves us asking 'What does variation in value mean and how is it to be measured?'

There is, however, a mode of meeting this difficulty, which is given in perhaps the clearest form by Cairnes¹. He has no doubt that when in discussing an advance in the price of butcher's meat, we ask whether meat has risen or money

¹ *Some Leading Principles*, Part I., c. i. § 1. Cf. also Mill, *Pol. Econ.* B. III. c. i. § 3.

fallen in value, "obviously there is a tacit reference to the "causes on which value depends: and the question really raised "is not strictly as to the change in the exchange value of meat "and money, but as to the cause or causes which have produced "the change. If we believe that the change is traceable to a "cause primarily affecting meat, we say that meat has risen in "value," &c. I cannot say that I agree with this interpretation of the ordinary notion of change in value. I think we should commonly speak of a thing as having fallen in value, when we found that it had fallen relatively to all other things, even though we might know the change to be due to causes affecting primarily these other things. But, however this may be, what concerns us most is to observe that Cairnes's suggestion does not really meet the difficulty above stated, of giving quantitative precision to our notion of a change in value. For if we ask, *how much* anything has changed in value, we require, on Cairnes's view, to measure the causes primarily affecting its value. But so far as these causes are diverse and heterogeneous (for *e.g.* the change may be due either to an alteration in the supply of the article or in the intensity of demand for it, which latter again may be variously caused), I do not see how we can find a common measure for them except by measuring the effect which they produce: which brings us back to the problem of determining 'value relatively to things in general.' But again, it is difficult to distinguish clearly the causes of change in value that 'primarily affect' a particular article from those that primarily affect other things. Take the case of an article of which the price has been raised by an intensification in the demand for it. This intensified demand may itself be merely caused by an increase in the supply of other things; as when society growing richer wants more old silver and is prepared to pay more for it. We can hardly call such a phenomenon a "cause primarily "affecting" the old silver; yet no doubt we should commonly say that old silver had risen in value under such circumstances. But suppose that the intensified demand were due merely to an alteration in social habits, without any increase of general wealth; still, even in this case, being the expression of an increased preference for old silver as compared with certain other

luxuries, it is the effect of a cause simultaneously affecting these other articles.

It seems then, that strictly speaking, the "causes primarily affecting" a thing that varies in exchange value reduce themselves to causes affecting its supply. Of such causes the most important, in the case of most articles, is a change in the amount of labour required for producing either the article itself or the instruments and materials employed in its production. In this way we are led to Ricardo's view that "all things become more or less valuable in proportion as more or less labour was bestowed on their production¹." By this Ricardo does not *merely* mean that, with certain qualifications, the "comparative quantity of labour expended on each" of two commodities "determines how much of one shall be given in exchange for another." This, no doubt, is the proposition that he is chiefly occupied in maintaining, in his discussion of the relation of value and labour. But unfortunately he does not quite clearly distinguish between a theory of the causes of a change in value and a view of what constitutes such a change. He maintains that a "commodity which at all times required the same sacrifice of toil and labour to produce it" would be "invariable in value;" thus implying, what he elsewhere expressly says, that "labour is a measure by which the *real* as well as the *relative* value" of things "may be estimated." But on this view the "real value" of things must be different from their "exchangeable value;" since an increase in the productiveness of labour, affecting all kinds of labour equally, would diminish the "real value" of all products, while it would leave the ratios in which they exchange for each other unaltered—so far, at least, as these are determined by the respective amounts of labour expended in producing them. I am not aware that Ricardo anywhere expressly takes this distinction between the "cost or real value" of things and their "exchangeable value;" but it is implied, as we have seen, in a certain portion of his language and is definitely stated by his disciple McCulloch. "Real value or cost," the latter holds, "is to be estimated by the quantity of labour directly or indirectly expended on its

¹ Ricardo, *Political Economy*, c. 1. § 1., cf. c. xx.

acquisition¹;" though it is only under circumstances that seldom or never occur that the "exchangeable value," even of a "freely produced commodity," exactly corresponds to its real value.

It is a rather perplexing question how Ricardo and McCulloch could deliberately adhere to the statements above quoted, while they at the same time drew attention to the differences in the value of different products due to the different degrees of durability of the capital employed in producing them—or, which (as Ricardo says) is the same thing, the different lengths of time required to elapse in each case between the application of productive labour and the transfer of its product to the consumer. At any rate all economists—except those Socialists who have ingeniously perverted Ricardo's inconsistency into an argument against the remuneration of capitalists—would now agree that in McCulloch's estimate of cost "labour and delay" (or some corresponding term) must be substituted for "labour" simply.

With this qualification, the Ricardian interpretation of the common notion of "real value" appears to me tenable; especially from the point of view that we are taking in the present book. As was before said, in the 'comparison of equivalents' which I hold to be essentially implied in the common notion of value, the exact nature of the equivalents compared is not determined; when, however, we think of the value of a particular product, we ordinarily consider it as exchanged for money or some other material wealth. But when we consider the valuable products of human labour (including money) in the aggregate, this kind of comparison seems inappropriate, since there remains no material thing outside the aggregate for which we could conceive the aggregate exchanged; in this case then it is natural to compare the aggregate of products with the labour (and delay) that it would cost to reproduce them—so far, at least, as we should desire to reproduce them. Hence it does not seem forced or strained to say that things in general have grown "really cheaper," meaning that society would not have to give so much labour and time in order to obtain them. For this reason I am not disposed to say that the question 'whether a thing costs more to produce' is an inadmissible

¹ McCulloch, *Political Economy*, Part II., c. 1.

interpretation of the question 'whether its value has really "risen;" although, as labour and delay are heterogeneous, it is difficult to make this notion of 'cost' quantitatively precise. Still, however important it may be to know the varying amounts of labour and time required to produce a given ware, such knowledge aids us little in measuring its variations in exchange value relatively to things in general.

This doctrine of Ricardo's should be carefully distinguished—as it is by its author—from the view taken by Adam Smith in adopting labour as the "real measure of exchangeable "value." The reason that Adam Smith gives for his view is that "labour never varies in its own value." In saying this he does not of course mean that labour does not vary in its *exchange value*: he is perfectly aware that "it may "sometimes purchase a greater and sometimes a smaller quantity of goods." What he means is that labour is always the same sacrifice to the labourer: has always, we may say, the same negative "value in use" for him. But even this statement if unqualified, is in palpable contradiction to common experience. An amount of work which would cause no sensible inconvenience to a man in health would be a grievous burden to an invalid; and almost all men like tasks, which they are conscious of being able to accomplish well, better than if they could only perform them indifferently. In fact, when we consider the higher kinds of skilled labour, it must be evident that the labourer often gets more enjoyment out of his work than he does out of anything else in life¹. So much, indeed, Adam Smith seems by implication to allow. He is thinking only of common labour; and even as regards this he only maintains that "equal quantities of labour, at all times and places, "may be said to be of equal value to the labourer," in the sense that "in his ordinary state of health, strength and spirits, "in the ordinary degree of his skill and dexterity, he must "always lay down the same portion of his ease, his liberty, and "his happiness²." The qualifications thus introduced are considerable; but even when so qualified, the statement cannot

¹ This seems to me a fundamental objection to any professedly exact measurement of labour by its painfulness such as Professor Jevons proposes.

² *Wealth of Nations*, B. I. c. v.

be admitted. In the first place the notion of "quantity of labour" is ambiguous. "Equal quantities of labour" would seem to mean labour of equal intensity for equal times: but then how are we to measure intensity? As Prof. Jevons says, "intensity of labour may have more than one meaning: it may mean the quantity of work done, or the painfulness of the effort of doing it." It is the latter of these characteristics which Mr Jevons chooses for measuring labour: but if we take this view, Adam Smith's proposition is reduced to the tautology that equally painful labour is always equally painful to the labourer; which can hardly be a reason for taking labour as a measure of value. If, on the other hand we measure quantity of labour by quantity of work done, Adam Smith's proposition comes into glaring conflict with facts; as will be evident if we imagine ourselves proposing to an average Bengalee in his ordinary condition to raise through a given space in a given time the amount of weight which would be cheerfully lifted by an average English navvy in his ordinary condition.

There seems therefore to be no sense in which Adam Smith's proposition can be accepted. But even if it were granted that labour has always the same negative 'value in use' for the labourer, I cannot see that this would be a sufficient ground for taking it as the standard of exchange value. For since at the same time and place the labour of one class of men certainly differs in exchange value from that of another class, we shall still have to choose which kind of labour is to be taken for the standard; and any such choice must necessarily be arbitrary, as the reason given applies equally to all kinds¹. And certainly when we ask whether gold or anything else has risen in value, we do not mean to inquire whether it will purchase more of a certain arbitrarily selected kind of labour; this may be in itself an interesting question to investigate, but it can hardly be maintained to be the real meaning of the former question, and it is no solution

¹ This objection applies *prima facie* to Ricardo's interpretation of value also: and is very inadequately met by the loose statement that "the estimation in which different qualities of labour are held comes soon to be adjusted in the market with sufficient precision for all practical purposes" (Ricardo, *Pol. Econ.* c. 1. § 2). Cf. post. B. II. c. 8.

of the difficulties of the first problem to substitute for it the second.

How then are we to deal with these difficulties? Some writers would decline them altogether. They would refuse to answer the question whether a thing has risen or fallen in value relatively to things in general; and only consider whether it had risen or fallen relatively to some specified commodity. In the chapter in which Mill discusses the 'Measure of Value' he seems to adopt this view. "A measure of exchange value" [of the same thing at different times and places], he says, "is impossible¹." But it is evident from other passages that he can only mean—what no one, I think, would now deny—that such a measure cannot, unless under exceptional and improbable circumstances, be made perfectly exact: for when the question is raised in a concrete case, Mill certainly holds that such a measure can be made sufficiently exact for all practical purposes. For instance, in the chapter next but one preceding, he has no hesitation in pronouncing on the extent of the rise in the value of gold, during the last five years of our long struggle with Napoleon; when the notes of the Bank of England were, to judge merely from the market-price of gold, depreciated thirty per cent. He tells us that "the state of Europe at that time was such...that the value of the standard itself was considerably raised; and the best authorities, among whom it is sufficient to name Mr Tooke, have, after an elaborate investigation, satisfied themselves that the difference between paper and bullion was not greater than the enhancement in the value of gold itself...the evidences of the fact are conclusively stated in Mr Tooke's *History of Prices*."² But if so definite a variation in the value of gold, between two different points of time, can be established on conclusive evidences, it seems at least misleading to say that a "measure of the value of the same thing at different times," relatively to things in general, "is impossible." Indeed it is clear that unless we can find such a measure, possessing sufficient exactness for practical purposes, we ought to abandon such inquiries as Mr Tooke's as chimerical.

But further, it seems clear that the default of such a mea-

¹ Book III. c. xv.

² c. XIII. § 6.

sure would seriously affect a good deal more of the field of investigation commonly claimed for economic science. For, as was before said, we commonly measure quantities of wealth by their value: we consider that a man has grown richer when the aggregate of things that make up his wealth has increased not in bulk or weight but in value. Of course, in ordinary thought, money is generally taken as an adequate standard of value for such measurements. Still, it is currently understood that money itself may rise or fall in value relatively to things in general; and the recognition of this fact has not been regarded as constituting any serious obstacle to the comparison of amounts of wealth at different periods, though it necessarily introduces a slight complication into such comparisons. It has been supposed that we have only to ascertain the amount of such rise or fall in the standard, and then make the requisite allowance for it in computing the increase or decrease of wealth between two different times. But it is evident that, in so far as we are unable to measure changes in value relatively to things in general, all comparisons between amounts of wealth possessed by individuals or nations at different times become proportionally inexact; unless some other measure than exchange value is taken, which will involve a serious deviation from the ordinary view of 'amounts of wealth.'

§ 3. It therefore seems to me fundamentally important to ascertain how far we can give a definite meaning to the question, 'whether the value of a thing relatively to things in general,' or its 'general purchasing power,' has risen or fallen. It will perhaps be convenient to take the particular case of changes in the value or purchasing power of gold between two points of time; since the way in which we should actually try to discover the amount of change that had taken place in the value of anything else would be to ascertain first whether its money *price* had risen or fallen, and then to consider whether any change had taken place in the value of money. In dealing with this latter point, if we found that all prices in gold had risen [or fallen] in the same ratio, we should obviously take that ratio to represent the fall [or rise] in the value of gold. But this could only occur by the rarest of accidents: the question then arises, if we find the changes unequal, and especially if we

find that some prices have risen and others fallen, on what principle are we to combine these different changes into one result? Professor Jevons, so far as I know, is the only writer who has noticed the different alternatives that present themselves at this point of the inquiry. He observes that, having examined the changes in the prices of commodities generally between two dates, we may say that gold has fallen in value, "however various and contrary the alterations "of prices, provided those rising preponderate in a certain "way over those falling. *It must be confessed, however, that the "exact mode in which preponderance of rising or falling prices "ought to be determined is involved in doubt.* Ought we to take "all articles on an equal footing in the determination? Ought "we to give most weight to those which are least intrinsically "variable in value? Ought we to give additional weight to "articles according to their importance, and the total quantities "bought and sold?"

"The question," he adds, "seems to be one that no writer "has attempted to decide—nor can I attempt to decide it¹."

It seems clear that there are several different ways in which the vague question as to "general purchasing power" may be made quantitatively precise; and that in the abstract it seems somewhat arbitrary to choose one rather than the others. But, if we are guided by the practical interest which men take in asking the question, I think we must adopt Mr Jevons' third alternative and consider different articles as differently important in proportion to the value of the total quantities bought and sold (assuming, for simplicity, that all that is consumed is purchased); in spite of an element of inexactness which, as will presently appear, this view inevitably involves. To make this clear, let us begin by considering the matter from the point of view of an individual. When a man asks how much gold will have changed in value twenty years hence, what he is practically concerned to know is how far at the end of this time his money will go in purchasing the articles which he habitually consumes. And if we assume that his consumption will remain unchanged, the question can be simply answered when the time

¹ The quotation is from a pamphlet on "A Serious Fall in the Value of "Gold."

arrives—supposing the requisite statistics attainable—by summing up the amounts of money paid for the things consumed, at the old and the new prices respectively, and taking the ratio of the difference to the whole amount expended. No doubt the result obtained by this method is likely to be different for different individuals, even at the same place. Suppose for instance that at the end of the time corn has risen in price and the finer kinds of manufactures generally have fallen; we shall probably find that a rich man has got to pay less for his habitual consumption, and a poor man more. But this does not seem to be in itself any reason against applying the method to ascertain the change in the purchasing power of gold for a whole community¹; since we have simply to treat the aggregate consumption of the individuals comprising the community as if it were the consumption of a single individual. The real difficulty does not lie here, but in the fact that the habitual consumption, whether of individuals or of societies, does not really remain unchanged between any two points of time. Even if we leave out of account all changes in habitual and conventional needs and desires, the mere fact that men generally buy somewhat more of things in proportion to their cheapness will cause alterations in the amounts of the different elements of their consumption. Under these circumstances the proposed method presents us with two alternatives; we may either take the total amounts of things purchased at the later period and consider how much they would have cost twenty years before, or we may exactly reverse the process. It is manifest, however, that these alternative procedures might lead to different and even opposite answers to the question, ‘What change has occurred in the general purchasing power of money?’ since it may easily be that men would have both had to pay more twenty years ago for what they buy now, and also more now for what they bought twenty years ago. Now I do not see any ground for adopting either of these procedures rather than the other; hence, so far as their conclusions diverge, we must say

¹ In what follows—to the end of the next paragraph—I assume, for simplicity’s sake, that the community may be considered to be in the same place, and to have only a single market.

that the question whether gold has risen or fallen in value does not properly admit of a single exact answer¹. However perfectly the facts might be known, there must always be a margin of inexactness in our determination of the amount of change, corresponding to the difference between the results of the two procedures.

But there is a further source of inexactness introduced into this calculation by the progress of the industrial arts. The products of industry keep changing in quality; and before we can say whether any kind of thing—e.g. cloth—has really grown cheaper or dearer we must compare the quality of the article produced at the beginning of the period with that of the more recent ware. But such a comparison cannot lead to any exact results; as we have to adopt the inevitably indefinite method of estimating the amounts of utility or satisfaction which either product is calculated to give to people in general. This difficulty reaches its maximum in the case where entirely new kinds of things have been produced or brought into the country by trade. To leave them out altogether might clearly vitiate the result: for a nation might be unable to buy for a given sum of money an equal amount of the articles that it used to consume, and yet might be able to procure a completer satisfaction of its wants by spending the money on newly introduced wares: while, further, the raised price of the former commodities might be indirectly due to the production or importation of the latter. Here again there seems to be no means of attaining more than a rough and approximate solution of the problem proposed; and to reach even this we have to abandon the *prima facie* exact method of comparing prices, and to substitute the essentially looser procedure of comparing amounts of utility or satisfaction².

So far we have been considering the difficulty of carrying a

¹ We might no doubt take the mean between the two results; but the answer so obtained is only made definite at the cost of losing practical significance.

² I do not mean to deny that we should generally obtain a sufficient approximation to accuracy by the simpler method of confining our attention to the articles of common consumption at both periods. But it is only by accident that we should thus get the *closest possible* approximation to the answer that we are really seeking.

standard of value from one *time* to another. But precisely similar obstacles stand in the way of our obtaining definite results, when we compare the different values of gold (or any other ware) in different places at the same time: and they can only be partially overcome, by methods similar to that just explained.

One point of some importance still remains to be determined. Ought we, in such a list of commodities as has been proposed, to include services as well as material things? This question, I think, will be most conveniently answered after we have made some progress in the task of defining Wealth; to which we will now proceed.

CHAPTER III.

WEALTH.

§ 1. IT is somewhat singular, that while the question of a Measure of Value has occupied a very prominent place in economic discussion—whole treatises having been composed almost entirely on this one point—no one, so far as I know, has expressly raised the question of Measuring Wealth. And this, again, is not because reflective attention has not been directed to the general notion of wealth; on the contrary, the right definition of wealth has, especially in recent times, been a good deal discussed; but the discussion has almost entirely related to the extent of the notion, the particular things that are or are not to be considered wealth; the standard of quantitative comparison among these different things has not been thought to require formal investigation.

Yet the need of such a standard, for scientific purposes, is tolerably obvious: since throughout a great part of the range of economic inquiry our object is to ascertain the amounts of wealth possessed or obtained either by communities of human beings taken in the aggregate, or by some group or class of persons within such communities. In either case we clearly want, if possible, some means of exactly measuring wealth; or if such a measure be unattainable, we want at least to know how far we can approximate to it.

The difficulties of such measurement hardly appear so long as we are merely considering and comparing the wealth of individuals (or even of classes) at any particular time and place¹.

¹ By "place" must be understood a region sufficiently limited in size not to admit of any material variation in the purchasing power of money within it.

The wealth of any individual is considered to include all useful things—whether material things, as food, clothes, houses, &c., or immaterial things, as debts, patents, copyrights, &c.—which being at once valuable and transferable admit of being sold at a certain price. This aggregate is suitably measured by its exchange value; the common standard of value, money, being taken for convenience' sake. Our object in such estimates is to compare the potential control of any one individual here and now, over all purchasable commodities, with that of any other individual; and, so far as such control is transferable, the ordinary mode of measurement enables us to make this comparison with as much accuracy as the imperfection of markets allows.

Our difficulties begin when we try to compare the amounts of wealth possessed by persons living at different times or in remote places; and they are further increased when we pass to consider wealth as possessed by communities taken as wholes, which is the special object of our present investigation.

The first class of difficulties coincide to a great extent with those that have been already examined in the preceding chapter. So long as we are only contemplating some one element of wealth, some particular kind of valuable article (of which the quality is supposed to be the same at the different times and places considered), we naturally estimate its amount as wealth by the ordinary measure of number or quantity. But when we have to compare aggregates of wealth made up of heterogeneous elements, it becomes necessary to reduce the units of quantity of these different elements to some common standard of measurement; and if we adhere to our original standard of exchange value, we have to deal with the problem of keeping this measure identical¹, in spite of the variations in relative value among the elements measured. But, as we have seen, this problem

¹ Some economists have confusedly spoken as if the problem was to find a *concrete* identical standard, some actual *thing* that did not vary in value. But the difficulty lies much deeper. For our present purposes it would not matter how much gold, or any other concrete standard, varied in value, if we had the power of accurately measuring its variations; since this power would give us an *ideal* invariable standard, which is all that we require for the exact measurement of wealth. But as it is we are unable to make even this ideal standard exact beyond a certain point.

does not admit of a complete solution. Such a measure—except under purely hypothetical circumstances—is liable to a certain amount of inexactness, the limits of which we can define, but which we are unable to remove; and in the effort to make it as exact as possible, we are reduced in many cases to an inevitably vague comparison between the utilities of diverse commodities.

But again, such comparisons are liable to be further vitiated by the varying relations of purchased to unpurchased utilities, at different times and places. We have already observed that in ordinary thought wealth is measured by its money value: thus it is natural that economists, while pointing out the defectiveness of this measure, should still have retained the characteristic of “possessing exchange value” as an essential part of the definition of wealth; and that in so doing they should have conceived themselves to be in harmony with the common sense of mankind. Accordingly they have excluded from the notion of wealth such unpurchased though useful things as the sun’s light and heat, air, the rain that waters the ground, water in rivers and seas, &c. They do not, however, seem to have observed the difficulties that this view involves, so soon as we try to compare the amounts of wealth possessed by human societies, inhabiting different regions of the earth’s surface. For we find that such useful unbought things are not merely indispensable, as instruments or auxiliary materials, to the production of things that have exchange-value; but—which is the important point—that they are instruments and materials of very various degrees of efficiency in different regions. Now since a large part of what is valued and exchanged as wealth consists in instruments and materials only useful as means of producing other wealth, it is paradoxical to draw a sharp line between purchased and unpurchased instruments and materials, so as to call a community “richer” because it possesses more of the former, though it may actually have less means on the whole of producing things directly useful. The difficulty becomes greater when the purchased and unpurchased instruments have a close resemblance to each other; as in the case where the water-ways of a country consist partly of canals and partly of rivers and

creeks. The difficulty extends in range when we observe how, as civilisation progresses, so important an instrument as land tends to pass over from the class of unpurchased to that of purchased utilities. It is manifestly contrary to common sense to say that a nation's wealth has increased because an instrument that it previously possessed has become valuable by becoming scarce. Thornton¹ has shown effectively the kind of error that may thus be introduced, in comparing the average wealth possessed by members of the same social class at different periods of a country's history. He points out that though an English peasant in the seventeenth century may have only had 5s. weekly wages, he often enjoyed also a rent-free site for his cottage, taken from the neighbouring waste, and unpurchased grazing on the neighbouring common for cows, sheep, pigs, and poultry. These things ought certainly to be taken into account, no less than changes in the value of money, in comparing such a peasant's share of wealth with that of an agricultural labourer now.

There is another case in which, for a different reason, exchange value is an obviously inappropriate measure of wealth. This is the case of products which, from their special adaptation to certain unique uses, could not possibly be transferred without losing most of their utility, and therefore of their value. A good deal of national property is in this condition; for instance, the Houses of Parliament in public auction would probably not fetch more than the merest fraction of what it cost to erect them. Such things are clearly part of the wealth of the community; but we cannot measure the *quantum* of wealth contained in them by the price at which they would sell if they had to be sold; nor, again, by the price at which they could be produced, for it may easily be that if they were destroyed it would not be worth while to reproduce them. In such cases, then, the standards of the market fail us; we have to fall back upon 'value in use.'

The same considerations apply, in a minor degree, to any kind of property that is more useful to the owner than it is to any one else. A man's command over the necessities and conveniences of life is not affected by any fall in the market value

¹ *On Labour*, Introduction.

of his property, except so far as he wishes—or may wish—to sell it: in proportion as he neither has nor is likely to have such a wish, exchange value becomes a manifestly irrelevant consideration in the estimate of his wealth.

§ 2. If, then, the common measurement of wealth by exchange value requires to be thus variously corrected and supplemented by estimates of utility, would it not be simpler, and really more consistent with ordinary thought, to take utility as the sole standard?

This is the view of Ricardo: who, regarding the value of a thing as directly proportioned to difficulty of production—or, as he loosely says, to “the quantity of labour employed in producing it,”—was necessarily led to separate the measure of wealth altogether from the measure of value; since, otherwise, he would have incurred the absurdity of denying that a country's wealth is increased by an enlarged supply of products due to increased facility of production. How then are we to measure utility? Ricardo treats this as a very simple matter. “A man is rich or poor according to the amount of necessaries and luxuries that he can command;” and therefore, if he gets two sacks of corn where he could only get one before, he gets “double the quantity of riches, double the quantity of utility, “double the quantity of what Adam Smith calls value in use.” This seems a very natural view, so long as we only contemplate a single kind of commodity: but as soon as we consider—what Ricardo does not seem to have considered—how to compare the utilities of different kinds of things, we see the fallacy of the view. For it is not merely the exchange value of things that varies with their degree of rarity or abundance; it is obvious that their comparative utility or value in use varies similarly from the same cause. Suppose a harvest of double the ordinary abundance in a fertile isolated country: the additional quantum of corn will obviously not have a corresponding quantum of utility; it may even be of no use except to burn, as is said to have been the case in the Western States of America. In fact, as Mr Jevons has admirably explained¹, the variations in the relative market values of different articles express and correspond to variations in the comparative estimates formed by people in

¹ *Theory of Political Economy*, c. 4.

general, not of the *total* utilities of the amounts purchased of such articles, but of their *final* utilities; the utilities, that is, of the last portions purchased. From the fact that when things become dearer people generally buy somewhat less of them, we may infer that they estimate the portion which they refrain from buying as only just worth the money that they previously gave for it, while considering what they still buy to be worth the higher price¹. If the price rose further, a further reduction of purchases would similarly indicate that another portion of the article was generally judged to be less useful than the amount still bought; and so on, for each rise in price. Hence when the supply of any article has been increased and its price consequently fallen, it is not really correct to reckon the total utility of the article as having increased in proportion to the increase in quantity; any more than it is correct to regard it as having decreased in proportion to the decrease in value. We ought to regard the additional quantum—so far, at least, as it is supplied to the previous consumers—as composed of parts of continually decreasing utility; the rate of decrease being measured by the fall in price, supposing the purchasing power of money relatively to all other articles to remain unchanged. If we assume the rate of decrease to be approximately uniform, we may regard the decrease in the average utility of the increment of supply as corresponding roughly to about half the fall in price. In this way we not only avoid the difficulties that arise in the measurement of wealth by exchange value; we also obtain a satisfactory explanation of these difficulties. On the other hand it must be admitted that this measurement by utility brings us into an awkward conflict with common sense, when we consider it as applied to variations in amount of things of any one kind; or even to variations in an aggregate of things that do not vary in relative value. Suppose that owing to improvements in pro-

¹ It should be observed that there is one case—not without importance when we are dealing with luxuries—to which this principle does not apply. This is the case of things desired and valued on account of their rarity. Of such things the total, and not merely the final, utility *pro tanto* is decreased by an increase of supply. A similar exception must be made in the case of money, as is noticed later.

duction the English nation became possessed of twice the amount of each kind of commodity that it now consumes; it would be paradoxical to say that its wealth had not doubled, as we should be obliged to do according to the view just explained.

A more intrinsic objection has already been suggested by the limitation with which I have stated Mr Jevons' doctrine. The demonstration that "final utility" decreases as supply increases involves the assumption that the additional supply of the cheapened article is purchased and consumed by the consumers of the previous supply; it is therefore inapplicable so far as the article is bought by different purchasers in different pecuniary circumstances. If tea, becoming cheaper, is bought by a poorer class, what reason have we for saying that what they purchase is not as useful as the dearer tea previously purchased by the rich? Indeed, is it not reasonable to suppose that a given commodity is more useful when bought by the poor, because the poor have fewer luxuries and therefore get more enjoyment out of what they have? In fact we are merely extending to wealth generally the principle established by Mr Jevons in respect of particular kinds of wealth if we assume that, on the average, each additional increment to the amount possessed by any one individual has a decreased utility. But in this case, if wealth were measured by its utility, 'amount of wealth' would partly be determined by the manner in which the wealth is distributed; and we could not say how much wealth there was in a country, till we knew how it was shared among its inhabitants. Nay, we shall even have to ascertain how it is managed in each separate household; since a given supply of material products is less useful in proportion as it is uneconomically consumed. Here, however, our divergence from common thought and common language would become so great as to cause serious inconvenience; and therefore, though we shall have hereafter to deal with the difficulties of measuring social utility, I do not propose to adopt this standard for determining 'amounts of wealth' in our present investigation. It seems best to acquiesce in the ordinary method of measuring amounts of wealth of the *same* kind by quantity, and comparing amounts of wealth of *different* kinds by their exchange value; being content to get over the diffi-

culties of carrying this measure from one time or place to another, in the imperfect manner above explained; and including even things that have no exchange value in one term of the comparison¹, if things similar in kind are included (as having market value) in the other term.

§ 3. There is another difficulty lurking in the conception of Utility as a measure of wealth, which it will be instructive to discuss. By the Utility of material things, as before explained, we mean their capacity to satisfy men's needs and desires. And so long as we regard these latter as constant, it seems easy and straightforward to say that men are richer in proportion as they are able to satisfy their needs and desires. But it is not quite so easy to deal with the case in which their needs and the means of satisfying them have increased *pari passu*; especially if the additional need is a need of protection against some pain or danger which did not previously threaten. Suppose (e.g.) that a country is visited by a new peril of inundation; and that, by the extra exertions of its inhabitants, an embankment is constructed. Are we to say that it has thereby become a richer country than before? Or again, suppose that climate renders the inhabitants of one country liable to diseases that do not occur in another. Are we to say that the former country is the richer of the two, if its excess of wealth consists merely in remedies, palliatives, and prophylactics of diseases specially incident to its climate? A similar question may be raised as regards means of protection against noxious animals; or, again, as regards material securities against mutual injury on the part of the citizens. Shall we say that one country is richer than another, so far as the former has castles with battlements and towers, which civil peace and security render unnecessary in the latter? If, on the other hand, we allow ourselves to be led by this kind of consideration to limit the common denotation of the term wealth, where are we to stop? For the greater part of the material products of any country are useful as means of protection against the organic pains due to cold, inanition, &c.; and in different regions very different

¹ The values of such gratuitously obtained commodities would of course have to be supplied from the corresponding articles included in the other term of the comparison.

amounts of the produce of labour are required to make such protection effective. It may be said that inhabitants of cold climates are not really richer because they require more elaborate houses, more clothing, more food, and far more fuel than the dwellers in warmer regions. I think it must be allowed that it would be in accordance with usage to call a country "really richer" in proportion as it has not more wealth on the whole, but more wealth to spare; and further, that this notion of "spare" or "superfluous" wealth is often that which most precisely represents what a statesman is concerned to know when he inquires how far a community is rich or poor; he wants to know how much wealth could be safely taken from its inhabitants, without interfering either with their health or with their productive efficiency.

The distinction, however, is not easily applied with any exactness to actual facts. In the first place what the members of a given society at a given time could spare—in the sense above defined—depends in an uncertain and varying degree upon previous habits, and upon mental and social conditions that are themselves variously modifiable. For instance, though the rich could spare a good deal of their habitual consumption without injury—or even with positive advantage—to their health; still, the standard of what is really required, to keep a man in good working condition, is to some extent higher in consequence of the habits formed by the enjoyment of wealth; though it is not easy to say to what extent. Again, we must notice that there is no sharp line to be drawn between the expenditure which increases efficiency and that which does not; in most cases, before we come to quite superfluous expenditure, we shall find a certain portion which increases the consumers' efficiency in a continually diminishing ratio to the amount consumed: thus a labourer may do a better day's work by eating meat rather than bread, while yet the difference between the value of the meat and that of the bread may be greater than the value of the additional produce of his labour. Still, in spite of this indeterminate margin, we may with advantage mark off—as clearly as may be—the spare or superfluous portion of the wealth of a community from that which is required to keep its members in proper working condition.

§ 4. In taking this last distinction there is another important point to be observed. The merest necessities of life may be regarded, in estimating the spare wealth of the country, as in a manner superfluous, if they are distributed in remuneration of superfluous services; so far, that is, as the persons rendering such services could and would supply their own necessities by the labour that they would be led to employ in this way if the demand for such services were withdrawn. It would, however, be simpler to consider the services themselves as superfluous products of labour, no less than if they were "utilities fixed and embodied in material objects." This leads to the question which came into view at the end of the last chapter; whether, namely, we ought not to define wealth so as to include such services. There is much to be said in favour of adopting this definition. Certainly what we commonly want to know when we inquire into the 'real wealth' of any class of persons is, as was before said, the extent of their command over the "necessaries and "conveniences" of life; and it does not seem a fundamentally important question whether these conveniences are fixed and embodied in material things or rendered directly by human beings. There would seem to be a certain absurdity in saying that people are poorer because they cure their diseases by medical advice instead of drugs, improve their minds by hearing lectures instead of reading books, guard their property by policemen instead of man-traps and spring-guns, or amuse themselves by hearing songs instead of looking at pictures. Again, when we reflect on the line drawn by common language between utilities "embodied" (as Mill says) in products, and utilities that are merely services, it certainly seems unsatisfactory. In fact, as Senior pointed out, it appears to depend "on differences "existing not in the things themselves...but in the modes in "which they attract our attention". When our attention is principally called to the *result* of labour, in altering the qualities of matter, we call this result a new product; when it is principally called to the act of altering, we consider this act as a *service* applied to a product previously existing. What influences us is not, generally speaking, the permanence or importance of the alteration, but the mode in which payment is

¹ *Political Economy*, p. 51 (2nd edition).

customarily made. The mending of shoes we treat as a service because we pay for it separately; but we consider that the cook at a restaurant 'produces' a dish, because our payment for his operations is lumped together with our payment for the material on which they were exercised. A distinction thus grounded can hardly be maintained as fundamental. It may be observed too that, in ordinary estimates of the aggregate income of the inhabitants of a country, directly useful—or, as we might say, "consumable"—services are commonly included: for as such services are reckoned as paid out of income, if we add the nominal incomes, estimated in money, of those who render such services as well as those who receive them, the result will only represent the aggregate *real* income¹ of the country, if this latter notion is extended so as to include services. Hence when we pass to consider, in the following book, how this aggregate real income is distributed among the members of the community, it would be inconvenient not to enlarge our conception of the aggregate distributed so as to include services as well as material products. Both the word "commodities" and the phrase "produce of labour" may, I think, be used in this extended way: and I propose hereafter to employ one or other of these terms whenever I require to express this wider notion. But usage, I think, compels us to limit the term wealth to things that are, if I may so say, stores or sources of utility comparatively permanent; as contrasted with the transient utilities derived from these sources, or furnished directly by human labour without the intermediation of any material product.

§ 5. But this view of material wealth as composed of permanent sources of utility raises a new question. Suppose we grant that services are not wealth on account of their transiency; still, there are other immaterial things which are permanent sources of utility, and why should not these be included in the notion of wealth? For instance, we consider that a chief result of a truly liberal education is to impart culture; that is to develop in human beings the capacities for realising certain elevated

¹ It should be observed that the aggregate nominal income represents more than the aggregate consumption of material wealth and services; since it includes also that portion of income which is really saved, that is, which takes the form of additional instruments, materials, &c.

and delightful modes of mental existence, consisting in attainment of knowledge, exercise of sympathy, or æsthetic emotion of some kind. Such modes of existence commonly require some of the material products ordinarily thought of as wealth, such as books, microscopes, pictures, &c.; but the capacities themselves are by far the most difficult and expensive conditions of making actual the possible utilities "embodied" in these luxuries. A man can buy the plays of Shakespeare for 3*s.* 6*d.* or less; but he cannot buy the capacity for enjoying Shakespeare without a vastly greater expenditure of his own and others' labour than 3*s.* 6*d.* would remunerate. Are we not then, it may be asked, to regard this culture, when acquired, as wealth, as much as the less important source of utility which we possess in the three-and-sixpenny volume? Certainly the facts just indicated should not be overlooked by the economist; it should be borne in mind that the expenditure of wealth and labour in imparting culture is an indispensable condition of realising the most important part of the utilities which we commonly but imperfectly conceive as attached to the material things that we call luxuries. Nor does the consideration that culture, not being transferable, does not strictly possess exchange value, appear to be decisive, at least when we are considering the wealth of the country; if we allow the term to include such material things as decorative public buildings, &c., which cannot, as portions of wealth, be measured by their exchange value. Still, here again, I regard the force of clear usage as irresistible; we must not call culture wealth; but we must all the more draw attention to its economic affinities to the material things that we do call wealth.

A still closer relation exists between the acquired skill of producers and the material instruments of production. It is obvious that a community may increase its means of producing commodities as much by improving the productive faculties of its inhabitants as by adding to its stock of inanimate instruments¹; and that it depends on circumstances which of

¹ It may be worth while to observe that the non-transferability of skill has a certain effect in diminishing the reasonable expectation of national advantage from producing it; since it somewhat increases the danger that the utility aimed at may not ultimately be realised. We may assume, generally speaking, that a machine will be used so long as it is worth using; since if

these two courses is at any time the more profitable employment of national wealth and labour. Hence the question whether skill is to be regarded as wealth places us in a dilemma. It is contrary to usage to call it wealth; and yet we cannot deny that so far as it results from labour it may be a form of investment of capital; and yet it is hardly less contrary to usage to call anything capital that is not wealth. The latter alternative seems to be on the whole the less objectionable; but I adopt it with some hesitation¹.

§ 6. There are, however, other immaterial things, such as debts, copyrights, &c., which being (unlike culture and skill) exchangeable, are—as we saw—commonly included in our estimate of the wealth of individuals. The question then arises how far we should include these in our conception of the aggregate wealth of the community? We will take first the most important case, that of Debts of various kinds. A debt may be regarded either as the creditor's Right to receive a certain sum of money or a debtor's Obligation to pay it; the two notions merely representing two opposite views of the same fact. Such a right or obligation being transferable is a thing that possesses a definite exchange value; while at the same time it is not a material thing; for the bill, note, bond or other document by which such a debt is usually represented is mere evidence of the existence of the debt and not the debt itself. And the least reflection will show how very large is the amount of these valuable immaterial articles owned by Englishmen; indeed most of the wealth of those who are not landowners or personally engaged in business consists of the debts owed them by governments, companies, bankers, or private persons. It is commonly thought, however, that such debts are not properly included in the inventory of a country's wealth, except so far as they are debts of foreigners; for the obvious reason that England's wealth cannot be increased by one English-

its present owner is too lazy to use it he can sell it; but as skill cannot so be transferred, it may remain unused, merely because its possessor can obtain as much wealth as he wants in some other way.

¹ Cf. *post*, c. v.: where it will be shown that the same difficulty has to be faced with regard to certain other utilities resulting from labour, but not embodied in material objects.

man lending some of it to another. This simple statement does not, however, quite meet the arguments that Mr Macleod has urged to prove that such debts are a real addition to a country's stock of wealth. I will endeavour to put what I understand to be Mr Macleod's argument in my own way. Suppose that *A* has lent *B* £100 in gold for a year at 5 per cent. There are then two things in existence; (1) the material 100 sovereigns possessed by *B*, and (2) the immaterial obligation on *B* to pay 105 sovereigns to *A* at the end of the year; which latter, as I have said, may equally be regarded as a right possessed by *A*. Now if *B*'s credit be good, this latter thing has actually the same exchange value as the former; and therefore the wealth of the two—if we measure wealth by exchange value—seems to be doubled by the transaction. The explanation of this paradoxical result is not, however, very difficult. *B*'s obligation to pay £105 a year hence has really a negative exchange value corresponding to the positive exchange value of *A*'s right to receive the £105;—that is, *B* would have to give any one else £100 to undertake the obligation—only there is not strictly speaking a market for the obligations of debtors, as distinct from the rights of their creditors, so that this negative value does not force itself on our observation. Still *B*'s obligation would be commonly stated, in any estimate of his wealth, as exactly neutralizing his actual possession of the £100: and this is unquestionably the right way of stating it, if we measure wealth by its *exchange value*. At the same time it ought to be recognised that this estimate overlooks the increase in utility on the whole, which generally speaking results from the transfers of material wealth effected by means of debts. A well-organized system of credit increases the productive resources of a country, just as a well-organized system of railway communication does; and this effect is especially striking in the case of certain kinds of debts, viz. those of bankers and merchants, which are used over and over again in transfers of wealth; and thus come to be a medium of exchange, which to a large extent takes the place of gold coin. Now so far as such debts (or the printed or written acknowledgments of them) serve as substitutes for the precious metals in the machinery of exchange, it seems unreasonable to include

the latter in our account of a country's wealth and reject the former. Suppose a country substitutes an adequate currency of banknotes for a portion of its gold currency, and buys goods from abroad with the coin saved, can we deny that its wealth has increased? The difficulty of doing so becomes more manifest if we vary the hypothesis and suppose the notes to be inconvertible—that is, not obligations to pay coin, but merely substitutes for coin to which the government gives legal currency. Such notes obviously perform the same function as the coin they represent and have the same (or nearly the same) exchange value, provided the amount issued be duly limited. On what ground then can they be held to be less wealth than metallic money? for if it be urged that such notes are not available for foreign payments, it may be answered that the land and houses of a country are a species of wealth that equally lies under the condition of being necessarily used *within* the country. Yet if we admit inconvertible notes to be a part of the country's wealth, it seems unreasonable to deny this attribute to convertible notes, on account of the obligation to redeem the latter in coin on demand: since the practical effect of this obligation is merely to necessitate the keeping of a reserve of gold equivalent to a portion of the notes; and all economists regard this as a cheap price to pay for the superiority of convertible to inconvertible notes. And what is true of bankers' obligations will be admitted to be true of other debts, so far as they perform the same useful function of enabling material wealth to be transferred to the persons to whom it is most useful.

At the same time it is not an easy matter to estimate the exact value to a country of its medium of exchange, when this consists partly of metallic money and partly of bankers' debts. For though the actual functions and exchange value of the two portions are the same, so long as the coin is used as a medium of exchange within the country, we ought not to overlook the *potential* value peculiar to the coin as being both available for foreign payments and capable of being melted down and turned to other uses without any considerable loss. Thus the question how far a country ought to be considered as richer for having more metallic money than another and using

a smaller amount of bankers' obligations, hardly seems to admit of a simple and definite answer; since we cannot apply the ordinary standard of exchange value to measure this potential utility of metallic money.

For these reasons—while it would be absurd to deny money to be wealth—it yet seems to me most convenient to omit the medium of exchange altogether in our comparisons of the wealth of different societies (or the same society at different times). But there are further arguments for adopting this course. In the first place we have to bear in mind that a medium of exchange does not become more useful in proportion to its amount. The function of money, so far as its employment within a country is concerned, will be no better fulfilled by a larger quantity than by a smaller; provided that our habits and customs of distribution and exchange are duly adapted to the smaller amount. Again, the amount of medium of exchange which a country uses, the value of its metallic money being given, does not depend solely on the amount of wealth other than money that it contains, but partly on the extent to which this wealth is exchanged. One country may have a larger stock of goods than another, and yet have less need of a medium of exchange, because its goods do not pass from hand to hand to the same extent or with the same frequency. Under these circumstances, if we suppose the value of gold to be the same in both countries, the other country will have to provide itself with a larger amount of the medium of exchange. But it would be misleading to say that this latter country is richer by this addition; because if this extra portion of the medium of exchange is not really useful to the country, it would be contrary to common sense to call the country richer; and if it is useful, its utility will to a great extent manifest itself in an increased production of goods other than money; hence, as we shall have already estimated the resulting increase of wealth in considering these other goods, it will be counting it twice over if we also reckon the medium of exchange at its nominal value, in addition to the goods¹.

¹ It should perhaps be observed that a portion of the utility of the medium of exchange will consist not in a greater production of useful things but in an increase of their utility through the better distribution that trade brings about.

§ 7. This last argument applies, however, to all the instruments and materials of production, and shows the need of a broad distinction between the two portions of a country's material wealth which we may distinguish as Consumers' wealth and Producers' wealth respectively. By Consumers' wealth I mean such material things as, like the 'consumable services' before distinguished, are directly available for satisfying human needs and desires; Producers' wealth (and similarly, of course, Producers' services) being only useful indirectly as a means of obtaining the former. What is commonly prominent in the thought of men when they speak of the increase or decrease of a country's wealth is certainly its stock of consumers' wealth; indeed we sometimes find in such discussions that the general term wealth is used in this more restricted signification¹. The distinction does not naturally suggest itself when we are contemplating wealth from the point of view of an individual: since an individual may at any moment exchange his land or his factory for any portion of consumers' wealth that he may desire; so that they are to him at least *potentially* consumers' wealth to the extent of their market value. But this consideration is in the main inapplicable to the whole community, which cannot similarly sell its land, factories, &c.: hence when we are discussing social wealth our attention is fixed in the first instance on things directly useful. Such things, in short, seem to be social wealth in a primary and special sense; while other things, only used and valued as a means to the production or conservation of these, are only to be called wealth in a secondary and wider signification of the term. It must be admitted that the boundary line between the two classes cannot be sharply drawn; there is an indeterminate margin of things which might plausibly be placed in either or both of these classes. Still this margin does not appear to be of great importance as compared with the aggregate of either class; and here as in other cases the impossibility of drawing a sharp line ought not to lead us to abandon a broadly important distinction,

¹ Such a view seems to be really implied in Adam Smith's language already quoted; since the "wealth of nations" into whose nature and causes he inquires seems to be interpreted in the first sentence of his work as "all the necessaries and conveniences which a nation annually consumes."

provided that we bear in mind the imperfect precision with which our classes are defined.

When this distinction is once taken, it is easy to see that it is misleading to add the amount of Consumers' wealth in a country at any time to that of Producers' wealth, and present the sum of the two as the "total wealth" of the country. For since there is no constant proportion between the two parts of the total thus heterogeneously composed, a country might thus fallaciously be represented as having grown richer in proportion to the number of its inhabitants, owing to an increase in the number and elaborateness of its instruments, when in fact its produce per head, prospective as well as actual, might have really decreased. It is to be observed, too, that the exchange value of durable instruments (including land) may easily increase without any addition to their productive efficiency: since what people are willing to give for instruments of production does not depend entirely on the amount that they expect to produce with them, but partly also on the relative value of future wealth generally as compared with present wealth: that is on the rate of interest. If the rate of interest falls, owing to the decreasing productiveness of the latest additions to the capital of the country, previously existing instruments of permanent utility—among which land is the most important—will rise in value without necessarily becoming more productive: and therefore if we simply measured the amount of wealth contained in such instruments by its exchange value, the country would seem to have received a large increment of wealth, merely through a fall in the rate of interest. This illusory result would no doubt be avoided if land and other instruments were included in the list of commodities drawn up for the purpose of rectifying the standard of value. But the objection would only revive in a new form; since the result obtained by striking a balance between the change in the value of money relatively to consumers' wealth, and the change in its value relatively to land, railways and other instruments of permanent utility, purchased for investment, does not really answer any question that we are interested in asking.

Here, then, we may decide the point left undetermined at the close of the preceding chapter; for it has now become clear

that the distinction really important to us, when we are comparing prices at different times and places, is not that between 'products' and 'services'; but rather that between 'consumers' 'commodities,' whether material or immaterial, and (products and services that are only useful as a means of producing consumers' commodities'. Any real gain in the latter, since it must consist in an increase in their productiveness, must ultimately manifest itself by a gain in the former. Hence in our endeavours to estimate variations in the standard of value, in order to infer from the nominal income of a community its real command over the necessaries and conveniences of life, we should confine our attention as exclusively as possible to variations in the prices of consumers' commodities: and so far as we estimate separately a nation's material resources for producing such commodities we should consider not the price at which they could be sold, but the amount they may be expected to produce.

§ 8. If the distinction above explained be admitted, the question whether debts and other immaterial portions of the property of individuals are to be reckoned part of the wealth of the community evidently assumes a new aspect; since they are at any rate to be considered as producers', not consumers', wealth, and are therefore to be estimated not by their nominal exchange value, but by their productive efficiency.

The estimate is often a difficult one to make; but it is at any rate easy to see that a knowledge of the exchange value of such immaterial commodities will help us little in making it. Take, for example, the rights to prohibit imitation of one's inventions and literary compositions by others, known as Patents and Copyrights. Here, it is obvious that the primary effect of patents and copyrights is generally to decrease

¹ As I have already said, the line of definition here is not one that can be sharply drawn; nor does it matter much how we draw it, provided that we draw it similarly in both terms of any comparison, and provided that no kind of utility be omitted or counted twice over. For example, it does not matter much whether in our lists of prices we take wholesale or retail prices; only, if we adopt the former course (which is obviously more convenient) we must estimate separately the services of retail traders and a part at least of the services of carriers. It is, however, more proper to include these services in our conception of productive labour. Cf. *post*, c. iv. § 2.

the amount of consumers' wealth produced in the country. The utility of the invention on which the patent is based may be very great; but it would be *primâ facie* greater if there were no patent at all, so that every producer might use it freely. Still, we believe that the ultimate effect of the establishment of patent rights is to increase the stock of directly useful commodities, through the stimulus given to inventive activity. But what a country gains in this way cannot be estimated with quantitative exactness, any more than what it gains by any other point of difference between a good and bad system of legislation; and it would be manifestly illusory to measure this advantage by reckoning the average exchange value of patents.

So again, there is an important element of truth in the fallacious reasoning by which it has been argued that our national debt should be included in the inventory of England's wealth, as much as capital sunk in land or railways; as the interest paid on it is paid for the use of money which has been thoroughly well invested in rearing the historic polity of which we enjoy the benefits.

“Tantæ molis erat Romanam condere gentem,”

and the “*civis Romanus*” has naturally to pay, like the shareholder in a railway, for the borrowed capital used in this great construction. The analogy is undeniable; no doubt money laid out in maintaining and improving Government is most productively expended, and should be so regarded; especially since any one who thinks the privilege of being an Englishman not worth the price is at liberty to transfer himself to a less expensive polity. Only we must not infer that England—any more than a railway—is worth more because it has cost us so much; still less that it is worth more because we had to borrow the money. This latter, however, is the inference implied in reckoning the Funds as a part of the country's wealth; as Mr Macleod and others are disposed to do.

It is all the more important to dwell on the real value to a country of its political organization (including its system of law) because, being common to all members of the community, it is not represented in any ordinary commercial estimate of the wealth of individuals. The case is otherwise with certain elements of that

more indefinite and spontaneous social organization which, viewed as a whole, is a hardly less indispensable factor in the actual production of the aggregate of utilities enjoyed by the community. The established relations of individual traders and professional men with other members of the community who habitually deal with them, are sources of gain to these individuals, admitting of more or less definite valuation. This is the case to some extent even with relations that are only partially transferable; as the Credit of a banker or merchant, which may be handed on through the continuity of a firm, but cannot be exactly sold to a successor. I may observe that in discussing the case of bankers' and merchants' obligations, employed as a medium of exchange, I have avoided the term "credit," as signifying ambiguously both the confidence which a creditor feels in his debtor, and the legal obligation to pay money which the latter incurs in return for the wealth lent him. But when a merchant's credit is said to be a part of his capital, the term generally denotes rather the confidence reposed in him by other merchants and bankers, which induces them to accept at their nominal value (allowing for ordinary interest) his obligations to pay money at some future date, rather than these obligations themselves. If this confidence diminishes, the merchant has either to borrow less or to pay more for what he borrows; and in either way is liable to incur a diminution of profits. In this sense, therefore, credit is a source of wealth to a merchant, of which the value is measurable by the additional profit that it enables him to obtain. The same may be said of the Reputation of a professional man, so far as it increases the demand for his professional services. But such reputation, though an important *source* of wealth to individuals, is yet not commonly regarded as being wealth, because it is in no degree transferable; any more than the professional skill on which—if well-founded—the reputation is based.

There is, however, another immaterial source of wealth to men engaged in business or profession, which has an intimate relation to their reputation; and yet must be distinguished from this latter, as it has the economically important difference of being transferable. This is what is variously known as Practice, Goodwill or Connexion; by which we

denote the fact that a considerable though indeterminate number of persons habitually use the services of a particular trader or professional man, and from the force of habit will mostly continue to use the services of any one who obviously steps into his place. Such settled habits of other persons are of course a considerable source of profit to the person whose services are employed; and in many industries they give to old-established houses a qualified monopoly of business, in some respects analogous to the monopoly of well-situated land from which a good deal of the wealth of rich landowners is derived. No doubt 'Goodwill' is a less durable article than land; it is easily destroyed by bad management, and some of it is necessarily lost in any transfer. But so far as it is capable of being transferred at a definite exchange value, we ought no doubt to include it in any estimate of the wealth of the person enjoying it. And I am not prepared to deny that this immaterial wealth of individuals may to a certain extent be rightly considered as a part of the productive resources of the community: for, as was before said, the establishment of certain definite channels of business, certain fixed habits of dealing with particular persons and companies, is a normal element of social organization; and we cannot conceive it annihilated without serious inconvenience to society. But it seems clear that the social utility of the Goodwill or Connexion of individual traders cannot in the least be inferred from its exchange value, any more than the social utility of their Credit or Reputation.

It may be noticed that in the case of 'Goodwill' or 'Business Connexion' what is actually bought and sold is commonly the legal right of using the name (as well as the actual buildings, &c.) of the dealer from whom the Goodwill is purchased. In the case of a physician's Practice, however, no similar external symbols of continuous succession are exchanged; what the physician undertakes to give in return for the money paid him is merely his absence and his recommendation; and it is a remarkable illustration of the force of mere habit, even in so important a matter as the choice of medical advice, that this recommendation—even when currently known to have been purchased—should have so high an exchange value as it appears actually to possess. But in neither case is the habit of dealing,

on which the profit of the purchase depends, really secured by any legal right. I draw attention to this point, because even in the case of patents, copyrights, &c., considered as portions of an individual's wealth, it does not appear to me exactly correct to say with Mr Macleod that the wealth consists in the legal right; but rather that it consists in the special productive advantage or utility, the means of making extra profit, derived from the fact of non-imitation, though secured by the legal right. For if the legal right were annihilated, the owner of the patent would remain just as rich as before, if only a general habit of non-imitation could be maintained among rival producers. Similarly in the case of any portion of material wealth, that which constitutes a thing wealth is the possibility of enjoying the utilities or satisfactions to which it is a means, secured to its owner by his legal right to non-interference on the part of others; and not this right itself. Hence in considering material wealth, though legal ownership is presumed, it is hardly necessary to draw attention to it.

We have now examined the chief questions that have been raised with regard to the definition of wealth. The results that we have obtained, so far as they are important at the present stage of our present investigation, will perhaps be most conveniently summed up at the outset of the following chapter.

CHAPTER IV.

CAUSES OF VARIATIONS IN PRODUCTION.

§ 1. THE lengthy discussion in the preceding chapter will not, I trust, have been thrown away, if it has assisted us in forming a clearer conception of the object that we have in view, in investigating the laws or conditions of Production. The term Wealth, as we have seen, is variously used in ordinary discourse, and may with perfect scientific propriety be diversely defined for the purpose of different inquiries. But in studying the Wealth of Nations what we are concerned to know is, Under what conditions different communities of men, or the same communities at different times, come to be “better or worse supplied with all the necessaries and conveniences for which they have occasion¹.” Hence our attention should be concentrated upon those directly useful commodities which I have called Consumers’ Wealth to distinguish them from the instruments and materials which are only useful and valuable as means of producing other wealth. It has to be observed that this Consumers’—no less than Producers’—wealth is of very varying degrees of durability; and the more durable portion of it has often been left rather out of sight by economists. When Adam Smith, for instance, speaks of the “annual produce of labour,” the term calls to mind the food that is eaten from day to day or the clothes that are worn out in a few years, rather than the houses, gardens, parks, pictures, jewels, &c., that are handed down from generation to generation. At the same time these latter must not be omitted in estimating the community’s command over the “conveniences”

¹ Adam Smith, Introduction.

—and even the “necessaries”—of life. A man’s house does not the less shelter him from the elements because it was built in the reign of Elizabeth; and if we ask why England now is richer than England 300 years ago, a part of the answer must be that each generation has added somewhat to the stock of such durable wealth as is not, except accidentally, destroyed in the using.

At the same time, this is no doubt a very small part of the answer required; especially since this stock of wealth not only requires continual expenditure of labour in care and repairs, and continual additions to take the place of what is slowly consumed, but is also held to need continual adaptation to the changing tastes of wealthy consumers. And perhaps it will be most convenient for the present to neglect this small element of inherited consumable commodities and consider society as continually supplying what it continually consumes, in respect of the comparatively durable part of its consumers’ wealth no less than of that which is rapidly destroyed and reproduced¹. But we must not forget the amount of error involved in this limitation of view; and we must also bear in mind that carelessness in preserving what has been produced, and the instability of taste and fashion which impairs the satisfaction derived from it, tend practically to reduce the annual supply of commodities just as much as a deficiency in quantity or quality of labour.

Further; we have seen that since it is not important to us whether the conveniences for which we have occasion are “utilities fixed and embodied in material objects” or services rendered directly by human beings, it is necessary for completeness of view to consider along with consumers’ wealth what I have called, for analogy’s sake, “consumable services”: and I accordingly propose to extend the terms “produce” and “commodities,” so as to include such services as well as material products. I also pointed out that, since a portion of wealth consists of books, pictures, microscopes, and other material

¹ As will be seen, a different view of this durable consumers’ wealth is attained in the following chapter, in which its analogy to Producers’ capital is brought out; but the difference is not very important for the present investigation.

means of literary, artistic, and scientific culture, and since the utilities embodied in these objects cannot be realised except by persons who have been more or less elaborately trained, it would be a mistake for us to leave out of sight the culture that results from this training, and the skill that is acquired and used as a source of immediate enjoyment, as a private person's skill in painting or piano-playing. Though we do not call permanent skill and culture, any more than transient services, by the name of wealth; still, since they resemble wealth in the two important characteristics of being results of labour and sources of satisfaction, the economist no less than the statesman or the philanthropist must keep them in view, in contemplating the growth of the resources for refinement and elevation of life which the progress of civilisation tends to furnish in continually increasing abundance.

At the same time, there is, I think, a decisive practical reason for not including any reference to culture, or to the labour by which in each generation it is developed and transmitted, in our present examination of the causes why different societies are better or worse supplied with commodities generally: viz. that the most important changes that we have to note and explain in society's command over material wealth, are very different in their nature and causes from the most important changes that have taken place as regards the possession and enjoyment of culture. Under the latter head, for instance, the varying quality and abundance of the services of painters, poets, educators, even priests would be a prominent object of investigation; and would obviously take us into regions very remote from that of Political Economy as ordinarily understood. On the other hand, for very similar reasons, it would be equally inconvenient to confine our view to utilities embodied with comparative permanence, in material objects. There are other utilities not so embodied, but equally derived from the application of labour to matter, of which the increased supply that a modern civilised community continually enjoys is due to causes similar to those that have increased its command over material commodities; and of which therefore the production is naturally and suitably considered along with the production of the latter. Such, for example, are the commodities of Conveyance

and Correspondence ; however important increased facilities of conveyance and correspondence may be as factors in the production of wealth: it would be absurd to put out of sight the utility of railways and telegraphs as conveying tourists and the messages of friends, no less than goods, commercial travellers, and messages of business.

The 'produce,' therefore, of which we are to examine the variations in amount must be conceived as something of which material wealth is the chief but not the sole constituent. For brevity's sake it will be convenient sometimes to refer to it as wealth: but we must be understood to have in view all the commodities derived from the application of the labour of a society of human beings to their material environment.

One more limitation of the inquiry—so far, at least, as it is pursued with any exactness—appears to me necessary. We had occasion to notice in the preceding chapter that the significance of comparisons between the amounts of wealth possessed by different groups of persons is liable to be seriously impaired by any important variations in their needs and desires. Thus anything more than a vague and general comparison between the annual produce of England and that (e.g.) of a tropical island would be obviously idle; indeed the assertion that the former nation is richer than the latter has hardly any meaning, except as referring to *spare* wealth. There is more advantage in comparing quantitatively the wealth of England with that of Germany or France; as the physical needs of the populations of these countries may be assumed to be approximately the same: and a similar assumption is perhaps still more legitimate in comparing England now with England a century or half a century ago. The primary needs of an Englishman, the food, clothing, shelter, &c., that his race and climate render necessary for his health can hardly have changed materially; and though secondary needs of tea, tobacco, newspapers, &c., may have developed themselves in him we shall have no hesitation in regarding the material means of satisfying these needs as a gain in the aggregate of satisfaction derived from material objects.

§ 2. The fundamental questions, then, which the Theory of Production attempts to answer, may now be precisely defined

as follows: (1) What are the causes that make the average annual produce per head¹ of a given community at a given time greater than that of another whose primary wants are not materially different, or greater than its own produce at a previous stage of its history? and (2) What are the laws of their operation? The answer to the former of these questions is somewhat complicated, but in no way doubtful or obscure: it merely requires a little care in reflective analysis to distinguish the different elements that enter into the productiveness of industry; though their mutual connexion is so close and intricate that it is a matter of some little difficulty to expound them in a clear order. But when we attempt to measure accurately the operation of any of these causes in the past, and still more when we try to forecast the extent to which they may be expected to operate in the future, we touch on points which controversy has found—or rendered—difficult and perplexing. It has therefore seemed to me desirable to treat these two questions separately; and to confine myself in the present chapter to a merely qualitative analysis of the conditions of Production, reserving for a future chapter the discussion of the more precise quantitative statements, which for distinctness' sake I propose to call the 'Laws' of Production².

The Production of a community, then, in our present view of it, may be defined as the adaptation by the aggregate of its labour, of external matter, organic or inorganic, to the satisfaction of the aggregate of its wants. According to the ordinary use of the term 'production,' this process is conceived as terminated when the portion of matter to which it is applied has received its final quality and shape; the conveyance and sale of

¹ We investigate the average supply per head, and not the total supply; because it is to the former that all assertions as to the greater or less wealth of a society commonly relate—we do not think that a nation has grown richer merely because, having grown larger, it consumes more food, clothing, &c. And we take the supply as annual, because the principal products of agriculture are actually produced at intervals of about a year; otherwise, of course, any other period would do equally well.

² For the present, therefore, we have no occasion to solve the difficulties that (as we have seen) stand in the way of our obtaining an exact common measure of amounts of wealth or produce at different times or places.

such finished products being regarded as separate and subsequent processes. But it will be more convenient here, and more consistent with the extended meaning which I propose to give to the term 'produce,' if we also extend the meaning of 'production' so as to include in it the labour of carriers and traders, no less than that of farmers and manufacturers. It is obvious that, for a given population, this whole process will tend to yield more or less of the desired result according as the labour is (i) applied under more or less favourable circumstances, or (ii) is greater in quantity, or (iii) more efficient in quality. I include under the term labour all kinds of voluntary exertion, intellectual as well as muscular, which contributes directly or indirectly to the increase of produce as above defined. The precise distinction, however, between "quantity" and "quality" of labour is not very clear in ordinary thought. On the whole, it seems most convenient to mean by "quantity of labour" merely *extensive* quantity, measured in two ways, by length of time and number of labourers. On this view we may distinguish four different ways in which the labour of one community may be less than the labour of another, in proportion to the whole number of the population, for (1) the workers may bear a smaller ratio to the non-workers, or (2) the number of years during which they work may bear a smaller ratio to the whole period of life, or (3) they may work for fewer days in the year, or (4) for fewer hours in the day. It may however be urged that we ought to regard labour as having *intensive* as well as extensive quantity; and no doubt we commonly speak of men as doing more or less work in the same time, meaning not merely that they produce more or less result, but that they make more or less effort. But since I cannot find any satisfactory measure of the amount of such effort, applicable to all kinds of labour alike, it seems best to include this source of variation under the third head of 'efficiency' of labour. The question is not of great practical importance; because the variations in quantity and quality of labour respectively are on any view largely due to the same causes¹.

¹ Mr Jevons, in his *Theory of Political Economy* (c. v.), considers labour as possessing intensive quantity; but his view of this characteristic does not appear to me very clear or consistent. In one passage (p. 185, 2nd ed.) he says

§ 3. Let us begin, then, by analysing briefly the differences in the productiveness of labour that are due to external conditions. In the first place the "spontaneous bounties of nature" (as they are called) are very unequally distributed: in some regions a much greater abundance is obtainable than in others of things directly consumable, or the materials or instruments required for making them or the materials of the latter: either without human labour, except the trifling labour of appropriation, or (more often) so as to need less labour than elsewhere to be expended in obtaining or preserving them or applying them to their appropriate uses. These variations are so obvious and familiar as not to need illustration. Almost equally obvious are the differences in the degrees in which land and water, the great permanent instruments of production (including conveyance), are naturally adapted for this purpose or capable of being made so. It should be observed, however, that these material advantages do not remain the same in all stages of industrial development: but vary with the varying amounts of labour applied and the varying efficiency of instruments and processes. Thus in newly settled countries the lands first cultivated are commonly not those that ultimately prove most fertile: so again the river-system of a country is fundamentally important for communication till railways are invented, but not

that "intensity of labour may have more than one meaning; it may mean the "quantity of work done, or the painfulness of the effort of doing it." But surely "quantity of work done"—or, as he afterwards says, "amount of "produce"—varying as it must with the material to which the labour is applied, the skill with which it is directed, the instruments that aid it, &c., &c., cannot possibly measure the mere quantity (in any sense) of the labour. And though the "painfulness" of labour is a characteristic of fundamental economic importance, it cannot possibly supply a universal measure of labour; since, as I have already argued, the assumption that labour is universally painful is in conflict with facts.

In another passage (p. 221) Mr Jevons says that "we may approximately "measure the intensity of labour by the amount of physical force undergone "in a given time." This view appears to me quite different from the one just discussed; since by "amount of physical force undergone" must be meant some effect on the labourer's organism, not on the material modified by his labour. But what the precise nature of this organic effect is, or by what standard, applicable to all kinds of labour alike, Mr Jevons proposes to measure it, I cannot discover from his examples.

afterwards: and similarly the ocean was long a barrier to navigators of inland seas.

Secondly, as we pass from one part of the earth's surface to another, we find similar variations in the conditions unfavourable to production or to the preservation of what has been produced: either periodic conditions of inorganic nature such as extreme dampness¹ or extreme heat; or occasional disturbances as floods, storms, earthquakes, &c.; or plants or insects noxious in various ways. Here also we may notice the direct physical effect of climate on the labourer's energy, as well as its effects in varying the period during which labour can be usefully employed in agriculture²: though these might equally be brought under the other heads.

In short, the external world upon which man operates requires in its original state very different degrees of adaptation to bring it to the same degree of aptitude for human uses. We have now to observe that, in the regions of the earth which have been for some time in the possession of civilised man, each succeeding generation receives its portion of the earth's surface in a somewhat different condition from the preceding generation. For the most part it finds its inheritance in a state more favourable to labour; the benefits of its predecessor's work being inextricably mingled with the "spontaneous bounties" of nature. These benefits may have been to some extent intentional, as when men plant trees that their children may reap the fruits; but for the most part each generation carries on primarily for its own ends the process which, from a human point of view, we may call the 'improvement' of the external world; only a considerable part of this improvement, being permanent in its nature, profits posterity as much as the improvers themselves. The later-born generation finds, along

¹ "During the rainy season, in the region of the upper Ganges, mushrooms "shoot up in every corner of the houses; books on shelves swell to such an "extent that three occupy the place previously occupied by four; those left on "the table get covered over with a coat of moss one-eighth of an inch in thick- "ness." Roscher, *Political Economy* (Lalor's translation), § CLIX.

² "In the countries on the Danube," says Professor Hearn (*Plutology*, pp. 74, 5), "the cultivation of the ground and the reaping of the crop are "spread over seven months; in the countries on the north of the Volga they "must be concluded in four months."

with fields originally fertile, others that have become so through labour spent in clearing and draining, embankments to ward off floods, tanks or canals for irrigation, &c. It finds that the beasts of prey that used to inhabit its land are either extinct, or reduced in numbers and scared from the haunts of men. It finds rivers made navigable and freed from "snags and rafts, rapids and shallows," harbours made more commodious, roads and railroad levels constructed. To maintain some of these improvements will require, no doubt, some labour of its own; but indefinitely less labour than was required for their original construction. So again, it finds species of plants and animals which have not only been tamed, but also by gradual breeding have been rendered more fit than they originally were for the satisfaction of human wants. This improvement, also, is not strictly speaking permanent: it might conceivably be lost: but it is not likely to be lost without a social catastrophe, and, generally speaking, it does not entail any additional labour on the generation that succeeds to it.

On the other hand, we have to notice certain respects in which the earlier generations are liable to render the land they live in worse adapted for the requirements of their successors. They tend to exhaust the useful minerals that are most conveniently situated for extraction—and also certain useful organic products accumulated in previous ages, such as Peruvian guano. They may exhaust the fertility of certain soils by frequent crops, so that these soils will afterwards require more labour to render them as fertile as they were originally. They tend to diminish the number of useful wild animals and drive them into places where they are more difficult to catch; and to carry the clearing of forests beyond the point at which the tree is less useful than the ground on which it stands. But these and other similar deteriorations, so far as we have yet had experience of them, cannot be said to weigh heavily in the balance against the improvements before mentioned.

There is however one specially important way in which a generation may find itself with a material environment less adapted to its needs, through the action of its predecessors.

It may find that, through the increase in its numbers, the country it inhabits has become too small for the most effective application of the aggregate of its labour: that is, the increase in the advantages of Division of employments (to be presently noticed) may be more than neutralised by the diminution in the proportional amount of agricultural produce that can be annually extracted from the land, in return for the extra labour applied to it.

Then, further, we have to observe that the gifts of nature are only useful so far as they are known; and that our knowledge of them has continually increased. As civilisation progresses, men discover, or enter into effective communication with, regions unknown to their ancestors,—regions containing new useful plants and animals whose products they may appropriate by exchange; they discover new possibilities of acclimatizing foreign plants and animals already known; they find new minerals in their own land. New combinations of matter, again, are accidentally produced in the development of industries, which are afterwards ascertained to possess unexpected utilities. To a still larger extent useful properties previously unknown or almost unknown are discovered in things already known, or new modes of combining properties already known so as to increase their utility. In all these ways the available bounties of nature come to be continually increased, by the progress of knowledge, for each successive generation. Here again the improvement is not absolutely permanent; it may be lost through the intellectual inertness of the later-born inhabitants; indeed, like some of the material improvements before-mentioned, it requires a continual expenditure of labour to maintain it. But this expenditure is trifling in comparison with the utility of its results; and is not likely to be pretermitted by any civilised society in its normal condition.

§ 4. In dealing with the first class of conditions of variable productiveness, I have been led to include one that might equally be placed in the third class. For the increase of our knowledge of matter and its properties, taking effect in what we call Inventions of new industrial processes, is properly regarded as one of the most important causes of improvement

in the efficiency of human labour. In another respect, again, the distinction above drawn between improvements in Man and in Nature, though on the whole convenient, is somewhat forced. For Man is a part of Nature; the productive qualities of man no less than those of plants and animals, exhibit differences that are, relatively speaking, original—that is, of which the origin is lost in prehistoric obscurity; and at the same time they are similarly susceptible of improvements that may be transmitted through physical heredity. This is true not only of such qualities as strength, energy, fineness of sense, &c., but also of higher intellectual aptitudes.

Again, as we have already seen, both the quantity and the quality of labour are directly affected by climatic influences, which render the labourer himself languid and inert, or render important kinds of work impossible for him at certain periods.

Passing from these conditions, which are in the main unalterable, we may notice variations in the quantity and personal efficiency of labourers which depend on such physical and social circumstances of the labourers' lives as admit of being at any time modified by the action either of individuals or of the society to which they belong. In the first place, it is obvious that the proportion of effective workers to the rest of the community will be less, other things being equal, where the population is increasing rapidly, owing to the larger number of children that have to be supported; it will be less, again, the greater the number of children that die in infancy, owing to want of care or want of proper food, clothing, &c. Again, unsanitary conditions of life tend in another way to reduce the quantity of labour performed by a given population; by diminishing, through premature death or early and prolonged decrepitude, the average proportion which the working period of life bears to the whole; and again, by diminishing the number of working days in the year, through increased frequency of incapacitating disease.

Similarly, bad air and water, uncleanliness, over-indulgence in alcohol, and other unhealthy habits may lower the physical tone of the labourer and thus impair the quality of his work without causing positive illness; on the other hand the strength

and energy of the labourer may be largely increased by an ampler supply of the necessaries of life¹.

Even more important than the differences in the physical strength and vigour of labourers are the variations that we find in their skill and intelligence, their foresight, quickness, vigilance, and resource in availing themselves of advantages that further production and avoiding or removing all that impairs it. Superiorities in these respects are partly, as I have said, congenital and transmitted through physical heredity: but to a great extent they are handed down from generation to generation by conscious training and learning; primarily by technical training and learning of special arts and processes, though the effect of general education in developing industrial intelligence must not be overlooked. We must also bear in mind the extent to which industrial efficiency is transmitted by association and unconscious imitation. "The child," says Prof. Walker, "becomes a better workman simply by reason of being accustomed, through the years of his own inability to labor, to see tools used with address, and through watching the alert movement, the prompt cooperation, the precise manipulation, of bodies of workmen. The better part of industrial as of every other kind of education is unconsciously obtained. And when the boy is himself apprenticed to a trade, or sets himself at work, he finds all about him a thorough and minute organization of labor which conduces to the highest production; he has examples on every side to imitate; if he encounters special obstacles, he has only to stop, or hardly even to stop, to see some older hand deal with the same²." This unconscious imitation operates powerfully in keeping up the habitual energy of individuals in a society when a high average standard of energetic work is maintained.

§ 5. Still, in explaining differences in the degree of energy of individual labourers or groups of labourers, as well as differences in the (extensive) quantity of the labour performed by a

¹ Hence—as we shall afterwards notice—differences in cost of labour to employers are often much slighter than, and sometimes even in opposite direction to, differences in the labourers' remuneration.

² *The Wages Question*, c. 3.

given population, a chief place must be given to differences in the strength of the motives for work presented to their minds.

Among these varying motives the most powerful is undoubtedly that "desire for wealth" which economists have often treated as the sole possible spring of industrial activity. In a previous chapter¹ I have argued that the very fact that this desire is derived from, or is a generalised form of, an indefinite number of more particular impulses, renders it legitimate to assume its universal presence; since there is no appreciable number of persons who do not desire, either for their own present satisfaction, or as provision for the future, or for donation or bequest to others, a larger supply of *some* kind of purchaseable commodity. None the less is it important to observe the different degrees of intensity in which the desire of wealth actually operates, in consequence of variations in the strength of the more particular impulses from which it is derived or generalised. Of these the most universal and imperious are the primary wants of food, clothing, shelter, and other necessaries. These primary needs, as we have already observed, are considerably modified by differences of climate and of the physical constitution of different races; and also somewhat by the traditional habits of different communities and classes. But even assuming them to be approximately uniform, the amount of labour required for their satisfaction must obviously be affected by changes in the productiveness of labour; and the stimulus to labour supplied by them will vary accordingly. Thus, for instance, it may happen that improvements in production, of which the benefit accrues to the labourers, are followed by a diminution in the quantity of labour instead of an increase in the quantity of produce.

It is, no doubt, a general law of human nature, that when these primary needs are satisfied, other desires requiring more or less wealth for their gratification tend to be developed, and to fill up the vacuum of impulse thus created. But the strength of these secondary impulses, as compared with the aversion to additional labour which acts as a counterforce, is a far more variable element than the urgency of the primary needs. The

¹ Introduction, c. iii.

sensibility to comforts, or the means of warding off slighter physical annoyances; the taste for sensuous luxuries, that is, for the means of increasing the positive pleasures that normally attend the satisfaction of physical wants, by variety and elaborateness in food, drink, furniture, &c.; the taste for ornament, elevated gradually into artistic sensibility; the demand for the emotional and intellectual gratifications furnished by literature, science, &c.; all these springs of action are operative in very various degrees in different communities and classes at different periods of their history. The progress of civilisation tends generally to increase their force—in fact such increase is involved in our common notion of the complex change that we call ‘progress of civilisation’—but the tendency is not uniform in kind or degree. And the influence of these desires as developed in individuals is again modified by the varying extent and manner in which custom and social sentiment intervene; either as prescribing certain comforts or luxuries as “decencies” of life in certain classes, or as stimulating efforts to rise above the standard socially prescribed in any class, in order to gain the higher social rank or reputation attached to the possession or exhibition of wealth; or, on the other hand, as reprobating luxury generally or particular species of luxurious expenditure. We have further to take into account the varying operation of the Affections, which multiply the attractive force of all objects of desire by extending the range of the persons for whom they are desired; and the play of the moral sentiments which variously combine with natural affections in prompting to such extension—thus (e.g.) the provision of wealth for children is an end sought with very different degrees of eagerness. Nor must we neglect the influence of the political organization of the community, in rendering political power more or less dependent on the possession of wealth. Again, it is to be observed that several of the desires above enumerated require leisure as well as wealth for their full satisfaction; also that very varying amounts of wealth are required for any given gratification—as in the case of the primary needs. Finally the resultant force of this complex play of motives is of course affected by any variations in the average dislike of labour; in considering which we may

especially notice the powerful effect of social sentiments and opinions; labour generally, or a certain class of labour, having frequently been regarded as more or less degrading.

But the stimulus given to labour by the desire for wealth does not vary simply according to the strength of this resultant impulse; it is modified at least equally by the extent to which the labourer is impressed with the belief (1) that additional wealth may be obtained and kept by additional labour, and (2) that there is no other more easy and agreeable way of obtaining it. Here it is to be observed, in the first place, that the range of opportunities of obtaining wealth has been largely extended and restricted by the action of government. What political conditions are most effective in securing the proportionment of reward to labour is a much controverted question, which will demand our consideration later¹. But there is no question that this security has often been impaired by the fact that adequate protection of earnings from spoliation has not been provided—as Mill epigrammatically says—“by the government and against the government.” Lack of protection by the government obviously involves the double detriment of discouraging honest labour, and encouraging the socially unproductive industry of plundering others—effects which are aggravated when the plunderers are armed with, or sheltered by, the authority of government: but “protection against the government” must be understood to include security not merely against the arbitrary seizure of property, but also against such oppressive taxation as discourages the accumulation of wealth.

On the other hand there is equally little question that the tutelage of government has often gone too far; that in certain communities at certain periods of their history the opportunities of obtaining wealth has been seriously diminished by the restraints which their governments have imposed on free choice of domicile and calling, and on the processes of industry and trade; or again that the sustenance gratuitously provided for non-workers, as by the English Poor-law from 1782 to 1823, has dangerously impaired the motives to industry. This latter effect may of course be equally produced by indis-

¹ Cf. *post* Book III. cc. iii. and iv.

criminate private almsgiving without the intervention of government. And similarly even when the government leaves individuals perfect freedom in the choice of calling and domicile, ignorance, or routine, or social sentiment, or strong local attachment may prevent them from choosing the business in which their exertions would be most productive and best remunerated.

Supposing the species of industry determined, the strength of the labourer's motive to exertion and care depends, of course, partly on the amount of his earnings; but it should be observed that the relation between the two is not one of simple proportion, as is implied in the statements of some economists; since if a man's earnings are already sufficient to satisfy all his keenly felt needs, the power of earning more by the same amount of labour may operate as an inducement to work less. It is more important to observe that the connexion between earnings and efforts depends greatly on the mode in which industry is organized. The connexion is most simply effective when a labourer works independently and owns the whole produce of his labour. So far as this simple arrangement is precluded by its incompatibility with the full advantages of co-operation, the labourer's interest in production will correspond to the precision with which, in dividing the produce of the combined labour, reward is proportioned to work. Different arrangements for attaining this result will be presently considered; here we need only observe that the deficiency of stimulus in the case of a hireling who works for a fixed wage may be partially supplied by careful supervision, if his wages can be easily raised or lowered at his employer's will, and if the competition for work among labourers is keen. Hence, distinguishing the work of employed labourers generally from that of their manager (whether the employer or his agent), we may draw attention to the special importance of adequate motives for exertion and care in the case of the latter: not merely because skilful management implies vigilant oversight and prompt command, but also because men catch skill, promptitude, and energy by unconscious imitation from their chief, and further feel a certain stimulus from the satisfaction of taking part in effectively organized performance.

For though, under present circumstances, the strongest stimulus to the energy of average men—whether employed or employers—is undoubtedly supplied by the desire of gaining wealth for themselves or their families; still we ought to recognise, as actual forces, both the desire of turning out good work, and the *esprit de corps*, which the mere fact of cooperating habitually for a given end tends to produce in average human beings, if the tendency is not overpowered by adverse influences, such as the consciousness of conflicting interests.

The foregoing analysis has led us more than once to consider differences in the moral qualities of labourers, as causes of variations in production. The economic importance of these may be briefly summed up thus; so far as it is made each labourer's interest to work his utmost, the more prudence and self-control he has, the more he will increase the wealth of the community; while again, the more he is actuated by sense of duty and wide public spirit, the more productive his labour will be under circumstances in which the coincidence between his own interest and that of society is wanting or obscure. The dishonest workman who scamps piece-work and is slothful if paid by the day, the dishonest manufacturer who employs labour and capital in producing the illusory semblance of utility, the tradesman who spoils his wares by adulterating them, all diminish produce. But besides self-interest on the one hand, and the influence exercised by common morality and regard for the general good on the other, we have to take special note of the narrower *esprit de corps* fostered by combinations of persons with similar interests; especially among the labourers in particular industries by such organizations as Trades-unions. So far as the rules of such associations, and the general opinion and sentiment which they produce or intensify, are directed towards the maintenance of a high standard of workmanship, their beneficial effect on production is obvious. In some cases, however, the rules and practices of Trades-unions have acted in an opposite direction, by resisting measures designed to economize labour; it being considered to be the interest of labourers in any particular industry that the field of employment should be as large as possible. How far this view is sound we do not now consider; here we have merely to observe that

the prevalence of this belief causes this narrower *esprit de corps* to diminish the productive efficiency of the aggregate labour of the community¹.

§ 6. In examining variations in the personal efficiency of individual labourers, we have been led to treat of the indirect effects of cooperation and association of workers, in developing skill and energy and *esprit de corps*. Let us now pass to consider the more obvious and important gains in productiveness of labour, due directly to the same association and cooperation.

We may notice first the more elementary advantages obtained by cooperation in its simplest form. There are many things which one man alone cannot do, but which are readily accomplished by the simultaneous action of several men. The raising of a given weight, for example, requires a certain force, which is obtained when the power of two men is simultaneously applied, but could not be obtained by any amount of successive effort on the part of a single man. But further, it is soon found that frequently little or no more labour is required to render a given service to several persons than is required to render it to one. "The fire and the water and "the care requisite to prepare the food of one person will "equally prepare the food of three or four. Consequently "when two men have to do two different things, if in place "of each performing his two several acts, they can with the "same or nearly the same effort perform for their joint benefit "each one act sufficient for the two, there is a clear saving of "half their labour²." Thus as simple cooperation increases power, Division of Employments, or as it has been called by economists since Adam Smith, "Division of Labour," economizes its use; and in this way division of employments would in many cases cause a most important gain, independently of any consequent increase of aptitude in the labourers whose functions are thus divided. Postal communication affords a striking example of this. There is not much room for increase of dexterity in the simple process of delivering a letter; the economic advantage of making letter-carrying a separate em-

¹ The loss to production caused by conflicts between labourers and employers as to wages will be noticed later in this chapter.

² Cf. Hearn, *Plutology*, pp. 124, 208.

ployment depends almost entirely on the great diminution of labour that each separate delivery requires, when one man delivers all the letters in the same street. In many cases, again, there is a great advantage in saving the time lost in passing from one set of actions to another; especially when the subdivision of employments is carried—as it is in many modern manufactures—so far that each worker has only to perform one very short series of actions, repeated as often as possible. Still by far the most striking advantage of the division of employments is the increased dexterity of the workmen; the vastly greater ease, rapidity, and accuracy which repetition gives to the performance of any act or set of acts. This I need hardly illustrate; since probably no paragraph in Adam Smith's works is so widely known as that in which he contrasts the number of pins that a man could make by himself with the number that he can make when in combination with others he confines himself to a single part of the process; and no point has been more abundantly exemplified by succeeding economists. And certainly the degree of additional efficiency that a worker can acquire, in work of a tolerably simple and uniform kind, under a highly developed system of divided employment, is greater than anyone without specific experience would have imagined. There is a further economic advantage in the fact that the training required to bring each labourer up to full efficiency tends to become shorter and less expensive, as the work he has to do becomes limited and simplified¹. A more important gain than this last consists in the economy of aptitudes that becomes possible, through the continually increasing variety of employments; there is thus greater opportunity of setting different individuals to do what they can do best; especially all new gifts and talents become indefinitely more profitable to society when their possessor can be set free from all work except that for which he is specially gifted². We

¹ To some extent this advantage is purchased by a corresponding risk of the labourer's being reduced to inefficiency, in case of his employment failing; but it may be observed that separation of employments in any particular industry does not always involve a corresponding specialisation of labour.

² Economists, however, have rightly drawn attention to the danger that threatens the mental development of the labourer through an excessive sameness in his work.

may notice as an instance of this that the chief part of the knowledge, foresight, and power of complicated calculation, that are indispensable to the successful conduct of many industries, need only be possessed by the comparatively small number of persons required for the function of management. Finally, the division of employments enables mankind to utilise to the utmost not only the special qualities of human beings, but similarly the superior natural provision of the materials or instruments of production in different countries and districts. Through this division each article consumed by any one may be produced in the place where the labour of producing it is most effective, due allowance being made for the labour and time lost in carrying it to the consumer ; and also for certain other disadvantages and risks which I shall presently notice.

The division of employments has different economic effects according as the co-operating workers are organized under one management, or under several different managements. So far as the simultaneous, or nearly simultaneous, combination of a number of different acts is required for the accomplishment of a single result, it is necessary that the labourers should be in one place, and obviously expedient that their work should be under the direction of one mind. And even when the operations to be performed on the same material, before it becomes a finished product, are merely successive, there is still a considerable economic advantage in uniting the labourers under one management, and, so far as is possible, either in one building or buildings nearly adjacent. For in the first place the most difficult and valuable kind of labour, that of management, is thus both economized and made more efficient in important respects ; *e.g.* it is easier to adapt the product to the changing needs and tastes of society when all the required changes in production can be carried out under one direction ; again, a more exact adjustment is possible of the supply of each kind of labour required, so that every class of producers can be kept in full work ; and further, there is less loss of labour and time in carrying the product in different stages from one set of producers to another, and taking care of it till it is wanted.

For similar reasons, an economy of labour, especially the labour of management, as well as of the utility of buildings and other instruments, tends to be realised, generally speaking, by any considerable (if well adjusted) increase in the scale on which a business is organized. A large business, too, can afford various kinds of expenditure on the whole profitable, which are too costly or too uncertain for smaller concerns: such as the employment of elaborate machinery, or highly skilled and specialised labour, outlay for experiments, for obtaining information¹, &c. The extent of these advantages, however, varies greatly with the nature of the industry; and in estimating it with a view to practical conclusions, we have to compare it with the drawbacks that attend industry on a large scale, especially if the terms of co-operation are adjusted in the manner that is at present most common.

We have already noticed that the conditions on which labourers working under one management agree to cooperate may differ materially. In most cases, in Europe at the present time, the labourers generally sell their services for a price independent of the value of their product, which becomes the sole property of their employer. Under these circumstances the advantages of division of employment are obtained at the expense of serious drawbacks. The most constant of these is the loss in personal efficiency of the labourer owing to the absence of any direct connexion between his remuneration and the productiveness of his labour. This loss can be but partly prevented by watchful supervision; and of course where overseers have to be hired, supervision is similarly liable to be less efficient. The detriment may also be to some extent obviated if payment be made by the "job" or "piece," i.e. in proportion to the amount of work done. But this plan (1) does not prevent waste of the employer's instruments and materials, so far as these have to be entrusted to the labourers; and (2) it is liable to lead to unsatisfactory performance, except where the work can be accurately marked out and its quality easily tested and estimated. Hence in industries whose produce

¹ I do not mention the advantage that a large business has in gaining connexion and custom; as it is more a private gain in Distribution than a social gain in Production.

tends to be largely, yet somewhat indefinitely, increased or preserved by minute and vigilant attention to details, together with occasional intensity of effort to meet emergencies, the keen interest which the employer feels in the result is a peculiarly important spring of effective labour. In such industries, therefore, it may be economically best—even at a partial sacrifice of the advantages of division of labour—to organise the separate businesses on a scale so small as to enable the employer's supervision to be everywhere effective, or even to render oversight almost unnecessary, the chief labour being that of the employer himself and his family; especially if the industry be one in which expensive machinery either is not profitable, or is only occasionally needed and may be conveniently hired. This seems to be at present the case in certain kinds of agriculture; and it is with regard to these that the advantage of Production on a small scale have been chiefly urged¹. The probability of superior management on the part of the small employer is of course diminished in proportion as he has to share with any one else the increment of produce obtainable thereby. This diminution is most simply and completely prevented when the cultivator is also the *owner* of the land he cultivates; where this is not the case, a nearly equivalent result might be attained by suitable contracts between the owner and the cultivator²; but such contracts have frequently been wanting.

But the customary mode of dividing the earnings of industry between labourers and employers involves a further risk of

¹ Cf. Mill, Book I. c. ix, where the kinds of culture mentioned include “not only the vine and the olive, where a considerable amount of care and labour must be bestowed on each individual plant, but also roots, leguminous plants, and those which furnish the materials of manufacture.”

² Some writers, who have followed Mill in advocating Peasant Proprietorship, seem to regard it as something more than a means of securing to the cultivator all the fruits of his labour; they speak as if the mere sense of ownership of the land on which a man labours supplied a peculiar stimulus to energetic labour. Without denying the existence of this sentiment, I may point out that it can hardly be included in the “desire of wealth,” which Mill and other economists treat as summing up all the springs of labour attributed to men in economic reasonings; and the motive is of too refined a kind to justify us, without more evidence than has yet been given, in assigning to it an important place among the springs of action of average men.

detriment to the aggregate production of the community, besides those arising from deficiency of stimulus to exertion; the danger, namely, of obstinate disagreement as to the price to be given for the labourers' services, resulting in more or less extensive and prolonged stoppages of work. Such stoppages have naturally been more frequent and more prolonged in the latest period of industrial development, in which Trades' Unions have been vigorous and active; and, whether immediately due to 'strikes' of labourers, or to retaliatory 'lock-outs' of masters, inevitably cause much loss of wealth to the community.

With a view of avoiding these various drawbacks other terms of cooperation under one management have been proposed, and to some extent tried. The loss of stimulus to energetic and careful work would be most effectually prevented if the labourers were remunerated by a certain proportion of the value of the product; but so long as they depend on the price of their work for their sustenance from week to week, this plan would render them liable to periods of destitution or extreme penury, owing to the fluctuations of the market. A course intermediate between this and the ordinary arrangement is to remunerate the labourer by a fixed minimum wage, with an addition varying according to the value of the product. This latter principle, the adoption of which constitutes what is often called in a special sense Cooperative Production, has been applied to various industries in schemes of which the details differ importantly. Sometimes only a fixed interest is paid on the capital employed in the concern; but more often the profit that remains, after paying both interest on capital and wages of labour at the current market rate, is shared between the owner of the capital as such and the labourers. Again, in the case of what Mr Holyoake calls a "Cooperative Workshop," the capital is chiefly owned by the labourers employed in the business, who accordingly form a joint-stock company, of which the manager is paid like all the other labourers, only more highly; while in another application of the principle,—sometimes distinguished as "Industrial Partnership"—the capital is mainly or entirely owned by a few persons, who retain the whole management of the concern in their hands, and are in

fact merely capitalist employers who have agreed to give their *employés* a share of their profits.

To trace fully the economic consequences of these variations belongs rather to the Theory of Distribution. Here it may suffice to point out that all these varying schemes have in common—though in somewhat different degrees—the advantages of supplying the labourers with additional stimulus both to activity and to economy; but that this advantage seems inevitably compensated, to some extent, by a diminution in the manager's motive to activity,—so far as he is actuated by self-interest,—in comparison with the motives that act on an ordinary capitalist employer. In many cases too the necessity of proving to the labourers that the division of profits is just would interfere with the secrecy requisite for the most efficient management of the business. In the "Cooperative Workshops" there are the further dangers, first that a body of shareholders receiving little more than the ordinary wages of manual labourers may be inclined to the mistaken economy of paying their manager inadequately, and so buying inferior management at a price dear though low; and secondly that their consciousness of having the ultimate control of the business may lead them not to leave him sufficient freedom of deciding large matters that cannot wait, and not to render him sufficiently prompt obedience in the ordinary course of the work.

It is to be observed further that these schemes do not afford complete security against conflicts among the cooperators. Wages, as I said, are to be paid at the market-rate; but it is precisely *against* the market-rate that strikes take place; and the labourers of any particular class within the concern may easily feel their community of interests with members of the same class outside, more strongly than they feel their community of interests with the differently paid labourers—including the manager—of their own business¹; especially when the cooperative business is not sufficiently flourishing to allow them a substantial bonus out of profits. They will no doubt avoid one source of conflict between labour and capital, as their knowledge

¹ Mr Brassey (*Lectures on the Labour Question*, vi. p. 131) mentions the occurrence of a strike in the Ouseburn Engine Works, "the most important "experiment in cooperative production hitherto attempted in this country."

of their own business will prevent them from having exaggerated views of the profits that capitalist employers are at any time obtaining; and it has been justly urged that in this way the "Cooperators" (in this narrow sense) may render an important service to other labourers and employers. It does not appear, however, that any of the schemes above mentioned has yet been applied so extensively and successfully as to enable this service to be realised: and indeed the whole principle of Participation of Profits is important rather on account of what is hoped from it in the future by thoughtful and instructed persons, than in virtue of the results that have been achieved by it up to the present time.

I now pass to consider the other mode of arranging the division of employments; according to which labourers or groups of labourers work independently and merely cooperate by exchanging their products. This form of cooperation occurs as an alternative, in certain industries, to the combination under one management of the different parts of a complex process performed on the same material: but it will be evident at a glance that it has a far wider scope. Indeed we may say that cooperation, in this sense, is nothing less than the fundamental principle on which the whole industrial organisation of society is based. It is manifest that the aggregation of particular sets of workers in single large establishments, of which we have been speaking, is only rendered possible through the tacit and unconscious consent of the rest of society to employ the services of these workers by purchasing their products. Without exchange, division of employment could not be conveniently carried very far, so long as the present system of private ownership was maintained unaltered: through exchange it might easily embrace the whole inhabited globe in one vast scheme of cooperation: and in fact its development only tends to stop at the point at which its advantages are outweighed by the drawbacks incident to production for distant consumers. The most obvious of these drawbacks lies in the additional labour and time spent in conveyance and communication between producer and consumer; but we have also to take into account the increased difficulty of adjusting supply to demand, owing to the difficulty that the producer has in obtaining full

information as to the consumers' needs; which entails normally an increased expenditure of time and labour in keeping finished products in warehouses and shops. In some few cases an absolute waste of such products has resulted from a great oversupply of a particular ware; the demand for which has been miscalculated. More frequently this kind of miscalculation has caused wares to be left in the hands of producers or traders for an inordinate length of time; has rendered expensive machinery and acquired skill temporarily or even permanently useless; and has inflicted on the industries thus disorganized, and others to whom the effect spreads from them, the more indefinite evils of general depression of energy and enterprise. These drawbacks and dangers, however, are in some cases at least not found sufficient to neutralize the advantages of producing at the distance of a great semicircle of the earth's surface from the consumer.

We must now observe that this wonderful development and spontaneous organization of industries, which we have just been contemplating, would not have taken place without a corresponding and simultaneous development in two other fundamentally important aids to the efficiency of labour, which we must now expressly notice. We may take first the one of which we have already had occasion to speak; the growth of man's knowledge of the external world, and also of his ingenuity in applying that knowledge, which, when combined, constitute what we call the "Progress of Invention." So long as invention was comparatively undeveloped, the extent of profitable cooperation, within the range of each particular industry, was closely limited: since so long as the processes of production are simple and rude, the economic advantages of breaking them up into parts are comparatively soon exhausted: it is not till Invention has rendered these processes elaborate and complicated that the brilliant triumphs of "Division of Labour" can be won. On the other hand, as cooperation through exchange is developed, and the general demand for the product of any particular industry extended, the field of the economic application of inventions is correspondingly increased: it may not be possible to use costly machinery, however ingeniously adapted to its work, unless the demand for its products is sufficient to keep it in constant employment.

Division of Labour, again, supplies more favourable conditions for Invention, since when the labourer's attention is concentrated on a few acts, he is more likely to discover improvements in the mode of performing them¹; while at the same time his increased skill renders him more qualified to profit by delicate and elaborate inventions.

In considering Invention as a source of increased production, we must extend the meaning of the term to include all expedients for saving labour or augmenting its utility; whether introduced in particular departments of industries, or in the great social organization of industries through exchange; and whether introduced with full deliberation by single individuals, or through the half spontaneous and unconscious concurrence of many. In this sense the transition, in an early stage of social development, from barter to money may be spoken of as an invention of the greatest importance; and similarly any later improvements in the machinery of exchange, such as the substitution of a good paper currency for gold and the development of a good system of banking. So again we may include the decimal system of measurement as an invention of first-class social utility; and the great economy of labour in the retail trade effected by working men's cooperative stores deserves the same appellation: and also all improvements in the legislative and administrative machinery by which the legitimate ends of governmental interference are realised. It should be observed, too, that many of the most useful improvements at a particular time and place in production are obtained by the application of inventions already known, but hitherto neglected from ignorance, inertness or some other cause. The economic history of all countries affords abundant instances of this; in recent times the introduction or development of systems of canals and railways in different countries are particularly impressive examples.

There are important economic differences between different

¹ It should be observed that most of the striking and (so to say) *revolutionary* improvements in industry have been made by persons of inventive genius not employed in the industry. But a number of smaller improvements, individually less noticeable but important in the aggregate, are continually suggested by workmen.

kinds of Invention. In the first place what is invented may be either a new instrument or merely a new process. In some cases a great saving of labour may be effected by a new application of natural forces to produce a desired result, without the intervention of any new tools. The application of the sun and air in bleaching, and of fire in clearing land for cultivation, exemplify this first kind of Invention. But it mostly happens that the new process discovered requires also new instruments or auxiliary materials which are themselves products of labour. In this latter case it is important to notice that the use of a more efficient instrument would not always involve a gain in the efficiency of labour on the whole: since the better instrument may require more labour to make and keep in repair, and it is possible that this extra labour might be more productive if applied in some other way.

But further, even when Invention has shown the way to a manifest saving of labour by the adoption of a new process, either with or without new instruments, it may still be impossible or inexpedient for the labourers to adopt it. For the new process may involve an increased delay in producing the desired result; and the labourers, requiring to support themselves from day to day, may be unable or unwilling to afford this delay. Or again, the new instruments may require other instruments or materials to make them at all, or to make them economically; and they may not be able to procure these. In either case we should ordinarily describe the obstacle by saying that the Invention could not be carried into effect for want of Capital. We are thus led to what economists have commonly held to be the most important source of increase in the efficiency of labour; viz., the accumulation of Capital. Unfortunately, this cardinal term is used variously and often ambiguously by different writers. Hence it seems desirable, before we proceed further, to make a systematic attempt to obtain a satisfactory definition of Capital.

CHAPTER V.

CAPITAL.

§ 1. THE terms "wealth" "value," which we have in previous chapters attempted to define, are in the fullest sense *common* terms: that is, they enter habitually into the ordinary thought and speech of all civilized men. "Capital" on the other hand is, when the scientific economist first begins to deal with it, already a semi-technical term; being habitually used not by men generally in their ordinary thought, but by men of business and others when discussing industrial matters. It will be found, however, that the difficulties of defining the term are not thereby diminished: on the contrary they are made more hard and rigid: since the signification which it is natural to give the term, from the point of view of a man of business, is different from that which economists have usually given it, and is not the most convenient for the purposes of most economic enquiries.

In its original use by practical men, "Capital" undoubtedly means "wealth employed so as to yield a profit;" whether this profit be gained by increasing the whole stock of wealth in the country, or by getting possession of the wealth of others in exchange for services. But English economists, investigating the causes of the increase of wealth in a country, have been led to restrict their notion of capital to the first of the two species just mentioned; and so to define it as "wealth employed in production." They were of course aware that they thus excluded from the notion certain kinds of wealth that were included in the former definition; such wealth, for instance, as the money that a usurer lends to unproductive consumers. But

they seem generally to have thought that this difference might easily be settled by regarding these latter kinds of wealth as capital to the individual, but not to the nation. Herein they have rightly indicated two essentially diverse points of view from which capital has to be regarded and from which it must—to some extent at least—be differently defined. I do not, however, think that the exact relation between the two views of capital has been altogether understood: and hence there has been some confusion in the use of the term, which I hope to remove in the course of the present chapter.

For clearness' sake, it will be convenient throughout to keep the two points of view as distinct as possible. Let us begin by asking what is exactly meant from the point of view of the individual capitalist, by "wealth *yielding* a profit." It does not mean that the wealth is necessarily in the form of instruments or materials for making new wealth, or in the form of food, clothing, &c., for the labourers who are using the instruments: for, as we have seen, it does not matter to the individual whether his wealth is used productively or unproductively, so long as he gets his profit. It merely means that the individual is using his wealth—either personally, or by lending it to others—in such a way that he continually finds himself possessed of the equivalent of what was originally devoted to such use, together with some additional wealth; this something more being what is called profit. Or, more precisely, we should say that the *hope* of finding himself possessed of this profit is his motive for thus using his wealth; since we should agree that capital does not lose its essential characteristics by becoming actually profitless. We have, therefore, first to ascertain what portion of a man's wealth is being employed so that its owner may continually become richer; and then to distinguish the capital from the profit. In the case of wealth that has been lent to some one else, there is of course no difficulty; as the sum which the debtor pays for the use of the wealth is clearly profit¹, and the sum which he is bound to replace clearly capital. And the line drawn

¹ I use the term "profit" here in a wide sense, including interest as one species

in this case can be ideally extended to include the case where the wealth has been spent in purchasing a perpetual annuity; for though here there is no one under legal obligation to pay at any fixed time an equivalent for the principal, still actually the annuity can be at any time sold at its market value, so that we may regard this possible price as the capital. In this case, however, the price at any time may be less or more than the sum originally spent; and therefore in calculating profit we have to subtract from or add to the sums annually received a sum just sufficient to compensate for the difference. This however is a simple matter of arithmetic, provided that the purchasing power of money may be assumed not to have changed in the interval. A rather more difficult question arises when we consider the wealth of a man employed in business. A good deal of it is, of course, clearly capital. "A manufacturer, for example, has one part of his capital in the form of buildings, fitted and destined for carrying on his branch of manufacture. Another part he has in the form of machinery. A third consists, if he be a spinner, of raw cotton, flax or wool; if a weaver, of flaxen, woollen, silk or cotton thread, and the like; according to the nature of the manufacture¹." But it is not quite so clear how we are to regard the money that he keeps uninvested, or the finished goods that he has in his warehouses; for though he will partly employ the former, and the proceeds of the latter, in paying his workpeople, replenishing his stock of materials, repairing or replacing his buildings or machinery, he will also employ part in supplying the consumption of himself and his family. Mill's view is that this question must be answered by considering what the manufacturer *intends* to do with his money, and with the proceeds of his goods when he has sold them. "The distinction between capital and not capital lies in the mind of the capitalist—in his will to employ them for one purpose rather than another." But granting that it is the intention of the owner of wealth, rather than the consequences of his acts, which determines whether that wealth is or is not capital; it yet seems more according to analogy to regard the wealth as becoming capital, not

¹ J. S. Mill, *Political Economy*, I. c. iv. § 1.

when the owner's intention is formed, but when it is executed; that is, not when the wealth is "destined" for profitable employment, but when it is actually being so employed. On this principle whatever part of the money that the capitalist keeps uninvested is required for current use in his business, should be regarded as capital. It may not be always possible to determine with certainty how much this is; the capitalist may not know exactly what money he keeps for business purposes and what for private consumption; and if he does not know, it is not easy for any one else to decide. But for purposes of general reasoning we may ignore this slight margin of uncertainty and suppose the line between the two portions clearly drawn—as it would be by a careful man of business—and regard the money that is kept for current use in business as a part of the owner's capital. The case of the stock of unsold goods is somewhat more complicated: but I think we should regard this as capital—if I may so say—pregnant with profit; since whatever part of its value is more than an equivalent for the value of the materials spent in producing them, the wear and tear of the instruments used, the wages of the labourers employed, and any other incidental expenses of production, should be viewed as *potential* profit, which will become actual when the goods are sold.

§ 2. It follows that we must, from our present point of view, reject as too restricted the definition of capital adopted by Ricardo, James Mill, and others, which states it to consist of "the food and other articles consumed by the labourers, the raw material on which they operate, and the instruments "of all sorts which are employed in aiding their labours"¹; thus excluding the finished products of the manufacturers of gold-lace, champagne, velvet, &c. For, obviously, such finished goods are a form in which an important part of the wealth employed for a profit by manufacturers and traders must always exist; and therefore the word 'capital' would not express any useful distinction in its application to the wealth of individuals if it were used to exclude such goods. Similarly, if we take the point of view of the community, it is equally true that

¹ James Mill, *Elements of Political Economy*, c. i.; cf. Ricardo, c. v.

some part of the "wealth employed in Production,"—if we use this term, as we saw reason to do, for the whole process of making wealth and getting it into the hands of the consumer—must exist always in the form of finished goods¹.

On the other hand reflection will show that the two definitions of capital first given are too wide to correspond to the ordinary usage of the term; since they clearly include *land* as one form of capital. For land is wealth: and most of it is wealth employed in production and with the view of obtaining profit. Yet English economists generally agree in excluding land from their definition of capital. Partly, perhaps, they may have been unconsciously influenced by the older "mercantilist" view of capital (still lingering in common thought and discourse), which conceived it by preference as money: since land is the one kind of wealth which—even when the Mercantile System was in fullest sway—was always broadly distinguished from Money. The mode, however, in which, for the most part, they have formally tried to distinguish capital from land, is by introducing a new characteristic into the definition of capital; that namely of being the "saved produce of past labour." But so long as we are defining capital from the individual's point of view, this characteristic seems quite irrelevant; for there is much other capital that has not been created by the labour or the saving of its possessor, and it cannot matter to him whether or not others have laboured or saved to produce it. I think therefore that a fundamental distinction between land and capital, extending throughout the whole range of economic discussion, must be abandoned. Indeed in considering the various industries in which land is employed, it would often be equally unusual and inconvenient not to be able to speak of the producers as having a certain portion of their capital in the form of land. Take, for instance, the case of a railway company; it is manifest that an important part of the real wealth represented by the nominal capital of the company consists of the land on which the lines run.

At the same time it is obviously necessary in the Theory of Production, when capital is considered and defined from the

¹ See Note at the end of this chapter.

point of view of the community¹, to maintain the received distinction between it and land. For in this view as we saw in the last chapter, we have primarily to consider capital as an aid in the application of man's labour to his material environment; hence we must define the term so as to exclude this environment itself, in its original condition; though at the same time we may recognise the increment of utility which land in its existing condition owes to past labour, by speaking of land not as *being* capital but as *containing* capital 'invested' in it. In fact the continual adaptation of the earth to human uses, which in the preceding chapter has been stated as one of the conditions of increasing production, is to be regarded as an accumulation of capital. Though to what extent the additional aptitude for human uses, acquired by the land in any given country within any given time, is due to the expenditure of labour with a view to its improvement, is not easy to say.

§ 3. It seems, then, that in defining capital from the point of the view of the community—what we may call "social capital"—we must restrict the term to such utilities as result from the labour of human beings; whether these results are invested in improvements of land, or in the rails and rolling stock of a railway company, or in any other form. We have now to observe that the results of past labour may be permanently productive, even if they are not "fixed and embodied in material objects." The labour of an engineer who plans a line, or of a consulting chemist whose advice is taken on the processes of a manufacture, have results really as permanent and as useful to society as the labour of the navvies and artizans who act upon their plans and advice; though we could hardly say that the results of the latter at any rate were "embodied" in the plant of the manufacture². Still less should we say this of the labour of the lawyer who defends a railway project before a Parliamentary

¹ The grounds for a similar distinction in the Theory of Distribution will be considered in the following book.

² It is not easy to draw a clear line between the results of labour that are, and those that are not, "embodied" in matter; and I have not thought it worth while to complicate the discussion by trying to draw it exactly, since the drift of my argument is that it is manifestly unimportant.

Committee, or of the 'promoters' who float the shares of a new company; yet if the employment of this labour is either absolutely indispensable, or is the most economical mode of starting the new business, the mere immateriality of its results seems a perfectly irrelevant reason for establishing a distinction between it and the labour spent in the physical construction of the instruments used in the business. Certainly the cost of the former no less than that of the latter remains permanently represented in the capital account of the company. When we ask what the shareholders have got for the money paid up, the complete answer is not given by enumerating the buildings and instruments; we must add that—through the labours of lawyers, promoters &c.—they have got a working concern; and if the concern is a profitable one, we have just as much ground for including the immaterial part of its construction in the capital of the community, as we have in the case of the material part.

This leads me to consider a source of profit, noticed in a preceding chapter, which exhibits the immaterial results of labour and expenditure as still more clearly separate from any material capital than in the cases just discussed. I mean the saleable article, called "goodwill" or "business connexion." Let us take for example, the business of publishing a newspaper. The sale of a newspaper when it first starts is ordinarily so limited that its proceeds do not repay the current expenses of production; so that the business has to be carried on for some time at a loss. Hence, in order that the undertaking should be on the whole a profitable one, it is necessary that the proceeds of the sale should ultimately be sufficient to pay profit, not only on the material capital actually employed in production, but upon all the wealth and labour that has been spent without return in the earlier years of the undertaking. The business may be regarded as having capital sunk in it, which would be recovered in its price, if it came to be sold; though it is actually represented merely by a certain habit of purchasing the newspaper that exists in the community at large. This potential price is properly reckoned as part of the wealth and capital of the individual owning the business; and so far as the establishment of such habits of pur-

chasing are useful to the community,—but only so far—we may also regard them as a part of ‘social capital.’

A striking example of the definite value of this source of profit is furnished by the business of banking; and it may be worth while to examine it specially, partly on this ground, and partly on account of the special prominence that has been given to it, by Mr Macleod and others, in discussions on the definition of capital. A banker's profit, as we saw, is largely derived from the tacit consent of the community to use his obligations to pay money on demand as a medium of exchange, equivalent to actual coin. In ordinary times, until a run on the bank occurs, these obligations are transferred from one customer to another, without payment being exacted¹. Hence, though in estimating the banker's wealth these obligations would be reckoned on the negative side, still, so long as he is not required to meet them, he is able to take as profit the whole or part² of the interest which he receives on the wealth, elsewhere invested, by which he would meet his obligations if required. Thus he may be only just able to pay what he owes to others, and yet be, so long as his credit lasts, a wealthy man. Suppose (e.g.) that he owes in this way £1,000,000 (without interest), and has debts of merchants, railway companies and the government, which together could be sold for £1,000,000. If there were a run on the bank and he had to suspend payment, his wealth would be found equivalent to zero; but meanwhile he obtains the interest of £1,000,000, which will leave him a handsome surplus, after paying the expenses of the bank. And since there is no reason why he shall not continue to enjoy

¹ It should be noticed that so far as that part of a banker's obligations called “deposits” is concerned, the consent of the community is to use the obligations of bankers generally as money, not those of any particular banker: since the recipient of a cheque on Bank A will in most cases bank with some one else, say B, and paying the cheque in from A to B will require a nominal transfer of money from A to B. But as such transfers among bankers, in ordinary times, will roughly balance each other, the effect is substantially the same as if the community consented to use the obligations of a particular banker; as it does when it circulates his notes.

² Part only, if he has to pay interest on the money that he owes. In the following example I have taken, for simplicity's sake, the case of an old-fashioned bank that does not pay interest on deposits.

this surplus for an indefinite period, his business might obviously be sold for a considerable price, even though its assets did not balance its liabilities, provided that the sale were a secret one so that its credit could be maintained. This fact, I conceive, is what is meant by saying that the credit of such a bank is a part of its capital; and the expression seems to me undeniably correct, provided we are careful to point out that such capital is of fragile nature, liable to sudden destruction in case of a panic. And, as we saw, there are strong reasons for regarding bankers' credit generally as an addition to the capital of the country; since the country gains by means of it a medium of exchange, which it costs very little to produce and maintain, and which at the same time is for some purposes as useful—and of course as valuable—as coin. It may be urged that the credit that is the immaterial source of this useful commodity is not the result of labour¹. But a man cannot get his obligations currently accepted as a medium of exchange, unless he goes into banking as a business; and a banking business cannot be created at one stroke, or unless the place and time for starting it be skilfully selected, nor can it be maintained without careful management—not to speak of the labour of subordinates. Hence this argument hardly affords an adequate ground for refusing to regard bankers' credit as a part of the capital of the community: though, as I have already explained², the medium of exchange—especially when partly material and partly immaterial, as in modern civilized countries—is distinguished from the rest of wealth by such important peculiarities, that it seems most instructive to treat it as something *sui generis*, and not lump it under the general term "national wealth" or "national capital."

§ 4. Let us pass to consider a third case, differing again from either of the two previously discussed, to which the notion of

¹ In accepting the proposition that capital is the result of labour, I must guard myself from being supposed to accept implicitly the doctrine that the value of capital or of other wealth is due solely to labour. As we shall hereafter see, there are cases when the labour employed is trifling compared to the value of its product. But if we distinguish capital from man's material environment in its original condition, as we have seen it needful to do, there is nothing properly included under the term which is not the result of some labour—some exertion, physical or mental, of some human beings.

² Cf. c. iii. § 6 of this book.

‘sunk capital’ may be applied. This is the case of wealth laid out in education. It is true that such wealth is not commonly employed for the profit of the person employing it; but this is often the case with other capital when the owner is advanced in years: he “plants trees that posterity may eat the fruit.” The skills and other qualities, however, that are the result of education, not being transferable, lack one of the normal characteristics of wealth: and I have followed common usage in not regarding them as wealth. Still, so far as such skill is the source of extra gain to its possessor, the wealth spent in producing it may be as profitably laid out for him as if it were invested in any lucrative business; and if this outlay has been incurred with a view to gain, I think we should regard it as a form of investment of capital, in spite of the paradox of saying that something is capital, which we yet do not assert to be wealth¹; though it will be well to denote its results by some such term as ‘personal capital,’ to express their peculiar characteristic of non-transferability.

Here, however, the question may be raised, whether if we speak of capital sunk in education at all, we ought not to extend the term to all the wealth consumed from infancy upwards, by persons who become producers, so far as it has been serviceable in developing their productive qualities—including, of course, their physical strength; and similarly to include the wealth consumed by them after they come to maturity, so far as it maintains their productive efficiency. And I admit that if we define capital, from a social point of view, merely as wealth employed so as continually to reproduce itself with a (social) profit, we ought in consistency to regard the labourers’ consumption of necessaries as an investment of capital, and the productive vigour that results from this consumption as a form in which social capital is actually existing. The chief reason for not taking this view is analogous to that before given for distinguishing between capital and land. It seems desirable in defining capital for the purposes of the Theory of Production to maintain the conception of it to which we were led at the close of the last chapter; that is, to consider it as a

¹ Cf. *ante*, c. iii. § 3.

joint factor with labour in social production, by the aid of which the labourers of the community are enabled to produce more than they would otherwise do. But in order to keep this view of it clear, we must distinguish it from the produce of which it helps to increase the amount so far as this is consumed merely with a view to enjoyment or support of life; and therefore from the bodily vigour and aptitudes for labour that are the natural results of this consumption. That is, we must regard as Capital not *all* the results of labour that are employed so as to produce a profit; but only such results as would not exist in their present form, or would not be used in their present manner, except as a means to some further result. On this view it is only so far as the labourer's consumption is distinctly designed to increase his efficiency, that it can properly be regarded as an investment of capital. No doubt, if an individual adopts a more expensive diet in order that he may be enabled to work harder without injury to health, the increase in his expenditure thus caused is for all economic purposes similar to outlay on fuel or other auxiliary materials in a manufacture. Similarly if statesmen or philanthropists are considering the desirability of increasing the labourers' share of food, clothing, house-room, &c., they may fairly recommend this outlay as substantially an investment of capital for the community, so far as it may be reasonably expected to lead to more vigorous and effective labour. Still, generally speaking, we must regard the consumption of produce, for the preservation or enjoyment of life, as the final end of the series of changes that make up the process of production; and accordingly must distinguish it broadly from consumption that would not be incurred, except as a means to further production.

It is not of course denied that the products consumed by the labourers will, generally speaking, have previously formed part of the capital of individual capitalists. Indeed it is often convenient for simplicity's sake to conceive a labourer's real wages as having previously formed part of his *employer's* capital; since, for most purposes, we may, without material error, suppose the employer to have purchased from other capitalists the food, fuel, &c. which the labourer will buy with his

money-wages, and to pay the labourer with these commodities. But, obviously, neither the money nor the commodities can form part of the employer's capital after he has handed them over to the labourer¹; he has exchanged them for the results of the labourer's work, whatever that may be; this latter is now the form assumed by the part of his capital which up to the moment of payment was in the form of money or commodities destined for wages. Even if the labourers are fed at the capitalist's own table the case is not substantially altered; only the moment at which the food ceases to be employer's capital is deferred until the time at which it is actually eaten.

§ 5. Here I may observe that there is something misleading in the manner in which economists have spoken of capital as being "accumulated," and at the same time have put forward, as the prominent and typical form of capital, the food, clothing, and other commodities which the labourer consumes. For though, as we have seen, there must always be a certain stock of such commodities, finished but undistributed, which forms a part of the capital of manufacturers and traders; still it is not this part of their capital that admits of being, in any important sense of the word, "accumulated." It is no gain² to the community that this store of goods should be larger than is required for the convenience of distribution; on the contrary one of the economic advantages which the improvement of the machinery for conveyance brings with it, lies in the diminution of the amount of these stocks which it becomes necessary to keep. What is really accumulated is mainly the results of labour in the form of what we may call generally instruments to make labour more efficient—including under the notion of instruments all buildings used in production, and all improvements of land.

¹ Unless in the exceptional case in which the labourer is paid *before* he has done his work; in which case the payment may fairly be regarded as capital lent to the labourer until the work is done, and then repaid in the form of this work done.

² I need only just notice the exceptional case of commodities such as wine that improve by being kept. It is, no doubt, a gain to the community that such commodities should be stored up, instead of being at once consumed. These, however, form a very small part of the whole.

That this, at any rate, is the view of capital which properly belongs to the theory of production, will perhaps become more clear if we conceive the community to be organized on a socialistic basis, its industry and the actual distribution of its commodities remaining in other respects unaltered: that is, if we suppose the instruments and materials of production to be owned by a government, which from time to time distributes the finished goods among the citizens, giving to the rich the luxuries that they now enjoy, on account of their superior deserts. Such a community, if governed with wisdom, and with due regard for the interest of posterity, would continue the accumulation of capital that is at present going on; that is, it would allot a certain portion of its produce to labourers employed in improving land, constructing railways, and other work yielding no *immediate* return of consumers' wealth. But it would be obviously forced and inappropriate to say that the produce so allotted was "saved" or "accumulated" and to call it therefore capital. What would really be accumulated, would be the railways, the machines, the additional productiveness of the land, &c.; or, to put it generally, the intermediate results of labour employed for remote ends, so that a possible increase in the immediate produce of consumable commodities is sacrificed for a greater increase in the ultimate produce. That the increase must ultimately be greater, unless the capital is wasted, is of course implied in the conception of capital as auxiliary to labour.

No doubt, in our actual individualistic society, this accumulation of instruments is brought about chiefly by the action of individual capitalists; who abstain from consuming the whole of their profits, in order to get more profit hereafter for themselves and their heirs. Hence it is a legitimate fiction to regard them as taking a part of their share in the food, clothing, &c., that constitute the real wages of their labourers; and to consider this accordingly as the first form in which capital always has existed, although the form in which most of it ultimately exists is, as we have seen, that of instruments. In this sense we may admit, with certain qualifications, Mr Jevons'¹

¹ *Theory of Political Economy*, c. viii.

conception of "free" or "uninvested" capital as consisting in the "commodities which are required for sustaining labourers of any kind or class engaged in work." The qualifications required are these. In the first place, it seems a natural inference from the statement quoted, that the first stage of the process of saving capital always consists in adding to the real wages of productive labourers an amount equal in value to the capital saved. And this view has certainly been adopted, more or less explicitly, by some economic writers (among whom, however, I do not include Mr Jevons); but, as I shall have occasion hereafter to show, it involves a fundamental error¹.

Secondly, in admitting that all capital may be regarded as *having existed* in the form of "commodities required for sustaining labourers," I do not mean to imply that all or even a large part of capital could exist simultaneously in this form; or that it would be no loss to the community if the capital in the form of instruments were destroyed, provided it were supplied—say from abroad—with an equal amount of capital in the form of the "current means of sustenance." No doubt the instruments could all be made over again in time, provided the labourers could be supported while making them; but obviously their labour would be of greatly inferior efficiency during the period that would elapse until the instruments were made: so that a very much larger amount of "free" capital would have to be consumed, to produce the "invested" capital that any civilised community now possesses, than would be required to produce an equal result with the aid of the instruments in which the capital is actually invested. Hence we must regard the form "instruments"—in the extended sense before mentioned—as that in which the greatest part of capital must necessarily exist, if capital is to fulfil the function of increasing the efficiency of labour.

Thirdly, it is important to bear in mind that the applicability of Mr Jevons' conception depends not on the necessary conditions of the Production of wealth, but upon the actual conditions of its Distribution. As we have already seen, the essential point in the formation of capital is the

¹ Cf. *post*, Book II. c. vii.

employment of labour for remote ends, rather than the saving of sustenance in order that it may be advanced to labourers and repaid by them in some equivalent product with a profit. Indeed historically the mode in which a good deal of the actual capital of any civilized community has been brought into existence is to be described by the former phrase rather than the latter—that is, it is the result of spare labour, but not of labour hired with a view to profit. At the same time it is quite true that in the existing economic condition of society the employment of labour in making instruments is principally due to the voluntary action of persons who, having the alternatives of “saving” and “spending¹” presented to them, prefer the former; and a fundamentally important part of the process initiated by their “saving” consists in the transfer of food, clothing, &c., from the stocks of traders to labourers, in return for the transfer to their employers of the results of their labour. Hence it is natural and right that attention should be prominently directed to the portion of capital that consists in finished products of the kind consumed by labourers: though, as I have said, it is only *before* such products are transferred that they can be regarded as forming part of the capital of the employers of labour.

§ 6. It is, however, a different question whether these products, after they have been transferred to the labourers or other persons who will ultimately consume them, ought not to be regarded as Capital belonging to these latter persons. According to the ordinary use of the term, in its application to the wealth of individuals, we must (as we have already seen) answer the question in the negative; and with Adam Smith distinguish from capital that portion of the “general stock of any society” which is “reserved for immediate consumption, but not yet “entirely consumed” on the ground that it “does not afford a “revenue or profit.” At the same time, reflection will, I think, show that this distinction is less fundamental than has commonly been supposed by English economists.

This will be most easily seen if we begin by considering the class of products which we have already distinguished as “durable

¹ That is, spending in luxuries for themselves or their families.

“consumers’ wealth”—houses, furniture, jewels, &c. : especially if we take the case of things of which the use is currently bought and sold separately from the ownership. For instance, the use of a rented house is a purchaseable commodity, which has to be included in a complete statement of the “real income” of the man who rents it; but, obviously, it has no important effect on the individual’s income, whether he spends £1000 in building a house, or whether he invests the same sum in railway stock and pays a part of the rent of the house with the interest.

It may be urged, however, that the house will be in time consumed; whereas the capital employed in production, if prudently invested, is continually replacing itself with a profit. This difference is certainly important; but it will appear, on closer examination, that it does not really exist, from the point of view of the community, in the case of a large part of the capital employed in industry. It is no doubt desirable to distinguish as clearly as we can from the rest that portion of the accumulated results of the labour of the community that is a permanent source of social profit; being really reproductively used, and thus continually reappearing with an increment at the end of each period of the process of industrial changes through which it is continually passing. But we can hardly use the term ‘capital’ to express this distinction; for we should thus exclude from capital not only all products that are not used for the support of labourers, or as a means of rendering labour more efficient, but also a large part of the products that are so used; viz. all instruments and auxiliary materials employed in the production of luxuries, and even products consumed by labourers if engaged in producing luxuries. No doubt the greater part of this wealth, at any given time, is in the possession of individual capitalists, by whom it is so used as to replace itself continually with a profit to its owners; because the price society pays for the luxuries produced exceeds the price of the labour spent, directly or indirectly, in producing them. But we cannot say that this wealth continually ‘replaces itself with a profit’ from the point of view of the community; since the luxuries it serves to produce, not being a means of supporting or assisting labour, cannot form a link in the per-

petual process of social production. The value of such capital is only kept up by continually appropriating a portion of the value of its produce to compensate for the consumption of materials and the deterioration and depreciation of instruments. And, just in the same way, if we value the annual use of a house at its market-price, we shall find (if the house has been economically purchased) that after subtracting ordinary interest on its original price a sufficient quantum of value will remain to compensate for its deterioration. The house, no doubt, only furnishes the immaterial commodity of shelter; but similarly railways and steamships, so far as they carry tourists, only produce the equally immaterial commodity of a desired change of place.

It may perhaps seem forced to carry the parallel further, and regard the house as an instrument that aids labour in producing the utility of shelter. But, as we have seen, the essential characteristic of the aid that capital in the form of instruments gives to labour is that by interposing an interval of time between the application of labour (i.e. of the labour spent in making the instrument) and the enjoyment of its result, the utility produced is ultimately greater than it would have been if the labour had been spent in some manner yielding more rapid returns: and this characteristic is no less present in the case where a certain kind of utility, as that of shelter, &c., can only be obtained by making a durable article that will be useful for many years. So far, indeed, as the alternatives of making a more or less durable house are presented, the question whether it will be economically advantageous to spend the extra labour required for the more durable building is clearly similar to the question that arises (as we have already observed) in considering whether an instrument that is undeniably useful is also profitable; we have to consider in either case whether the additional utility is worth purchasing at the price of the additional labour, taking into account the time that must elapse between the application of the labour and the consumption of the utility. It is of course true that up to a certain point these alternatives are not presented; there is an irreducible minimum of durability which a house must possess, in order that the utilities derived from it may be obtained at all. But there seems no more reason for

excluding this minimum from the definition of capital than there is for excluding such instruments as are absolutely indispensable to the production of certain commodities. Either expenditure of labour yields us equally the intermediate results of labour employed for remote ends; and in either case, if the labour has been economically applied, the utility ultimately resulting will be estimated as worth the delay that it has cost, whether derived from the house or the instrument: both these therefore would seem to be equally forms of capital. And the same may be said of all durable products from which we expect to derive continued or repeated utilities in the future; the thing itself in relation to its future utilities has the essential characteristics of Capital. The difference between the case of wealth that yields present enjoyment to its possessor as well as the promise of future utility, and wealth that is only valued in view of produce to be hereafter enjoyed, is no doubt of importance: we may perhaps represent it by designating the former as "consumers' capital" and the latter as "producers' capital." But in taking this distinction we must bear in mind that many most important instruments that are "producers' capital" from the individual's point of view are at least partly "consumers' capital" from the point of view of the community: such as railways and steamships so far as they carry tourists¹, &c.

But further; when after observing the analogy between producers' capital and consumers' wealth, of which the utility is continuous or frequently repeated, we have to consider the consumers' stocks of food, fuel and other things consumed in a single use, we can hardly refuse to recognise even in these latter, so far as their amount is economically regulated, the

¹ To avoid misapprehension, the reader should be warned that afterwards, in expounding the Theory of Distribution, the 'capital of the community' will have to be defined differently. It will have to mean the fund on which Interest is paid; that is, the aggregate of the capitals of individual members of the community; an important part of which—e.g. the national debt—is not to be counted as capital from the social point of view, from which in the present book we primarily contemplate the production of wealth. How far this aggregate capital of individuals should—by an extension of the notion of interest—be taken to include their 'consumers' capital,' is a question which will be hereafter considered.

essential characteristics of capital. It is true that such commodities do not, generally speaking, increase in utility by being kept, but are rather liable to deterioration: still, so far as they are prudently kept they save the labour of multiplied purchases and journeys which would otherwise be necessary. The keeping of such stocks therefore is as essentially a labour-saving expedient for the individual as the use of an instrument in production. The stocks in the hands of manufacturers and traders fulfil the same function for the community; and the social advantage of having more or less of such stocks is to be measured by the extent to which their existence either saves the labour of sale and conveyance, or renders the labour of making more productive by enabling it to be more continuous and uniform, and organised on a larger scale, than would otherwise be the case. As we saw, it is only so far as they are thus useful that the community gains from the "accumulation" of such products; and it is in view of this utility that they may fairly be regarded as capital of the community.

It would seem then that the term 'capital,' as scientifically used, is not so much adapted to distinguish one portion of accumulated wealth from the rest; as rather to express an aspect which all such wealth presents—so far as it is produced and used with due regard to economy¹—up to the very moment of consumption: as being, namely, the intermediate results of labour employed for future utilities, which in some way or other are greater in proportion to the labour required for enjoying them, through the prolongation of the interval between the labour and the enjoyment.

Hence, to return to the question raised at the close of the preceding chapter, when it is said that, in a given society at a given time, an invention tending admittedly to render labour more productive cannot be carried into effect for want of capital, the essential fact implied, from a social point of view, is that the community cannot or will not spare the labour required to obtain this increment of produce from work more imme-

¹ It should be admitted that this aspect is actually presented, for the most part, in a less degree by Consumers' capital than it is by Producers' capital; inasmuch as the former is commonly managed with a less strict regard to economy. This difference, however, is by no means universally to be found.

diately—though less ultimately—productive. But in our existing societies the future gain of labour thus socially spared does not usually accrue to the labourer personally; but to others who practically purchase the results of his labour with an equivalent amount of directly consumable commodities; and in so doing are said to “save” the resulting addition to the real capital of the community. How far the laws governing the extent of such saving admit of being precisely ascertained, is a question reserved for the next chapter.

NOTE. The mistakes that may arise from not contemplating with sufficient distinctness that portion of capital which continually exists in the form of unsold goods, are, I think, exemplified by the defects of Mill's argument to prove that “demand for commodities is not demand for labour.” This proposition, which has occasioned a good deal of polemical discussion, is, I believe, perfectly true when properly explained; and Mill's argument in support of it appears to me to a great extent sound. I think, however, that it is all in form unsatisfactory, especially when we consider the early stage in his exposition at which it appears. He keeps too much to the general notion of “capital” without closely tracing the different shapes which the capital takes during the changes; and thus on the one hand he fails to state an important—in my opinion quite legitimate—assumption on which he proceeds; and on the other presents a vague and misleading view of the *time* at which the results of which he speaks will be realised. And in consequence of this latter defect I think that a part of the argument—that which compares the effects of a purchase of luxuries in a shop with the employment of labourers to produce luxuries—is quite erroneously stated.

The puzzling nature of this question (for I think most reflective readers of Mill find it puzzling, after all the pains he has taken to make it clear) is due to the fact that it has two obvious aspects, each of which presents it as very simple and comprehensible, while at the same time they lead to opposite conclusions. First, it seems plain enough that purchase being a mere exchange of equivalents, a man who purchases can only benefit himself. If a man happens to have a stock of wealth in a form in which he can consume it himself, it is obvious that he does not benefit any one else by consuming it; then surely the mere fact that he has it originally in an unconsumable form, and has to exchange it into some other shape in order to consume it, cannot alter the matter. On the other hand, it is said, consider what actually happens in any particular case. I have £100, which I may either save or spend in velvet. If I save it, I no doubt add £100 to the amount of wealth seeking productive employment; and we will suppose for the sake of argument that it will find employment without delay, and that a portion of it will go to increase the wages of labourers.

But if I buy velvet with it, does not the same result, so far as the wages are concerned, necessarily follow, at least if we deduct the percentage which the velvet-maker may add, as fairly earned profit, to his domestic consumption? What remains he will either employ in his business, or, if he has no room for it, will invest elsewhere; and in either case a portion, which we have no reason to suppose smaller than in the former case, will go to increase wages. Surely it is mere paying with words to say that I have not added to the velvet-maker's capital, and that some one else would have bought the velvet if I had not? Some one else when he comes will find other velvet to buy, and we may if we like raise the same question over again, and ask, What becomes of his money? Our present concern is with my £100, most of which is as likely to be spent in wages, raw materials, machinery, &c., if I give it to the velvet-maker for velvet, as it is if I put it in a bank.

I must confess that both these views seem to me perplexingly plausible; and Mill's argument does not appear really to meet what has just been urged in favour of the latter. In order to meet this, it is necessary to express an assumption which is obscurely implied in Mill's reasoning, viz., that the average amount of the velvet-maker's capital which is locked up in unsold goods cannot be decreased by my purchase. This amount is, of course, continually fluctuating in the variously caused oscillations of supply and demand. But it is obvious that it must tend to bear some direct proportion to the amount of purchases, so far as it is influenced by this. Hence we may assume that, *ceteris paribus*, the decrease in the stock of velvet caused by my purchase of £100 worth, will be balanced by a rather more than proportionate increase in the stock at some future time. When this latter takes place, the loss to the labourers due to my purchasing velvet instead of investing will be fully realised. But it certainly will not be realised immediately; and hence, as I said, Mill is certainly wrong in supposing that if I spend the £100 in employing labourers to make an artificial lake instead of spending it in velvet, the wages-fund is at once larger by £100 than it would have been in the latter case.

But, granting it to be substantially true that the consumers of luxuries do not "demand labour" in Mill's sense—i.e. do not supply the real wages of the labourers who produce the luxuries—the question remains, how far the capitalists as such can properly be said to do this. An answer to this question, differing materially from Mill's, has been implicitly given in the present chapter; but the full statement of it will come more appropriately in the following book (cc. vi. and vii.).

CHAPTER VI.

THE LAWS OF PRODUCTION.

§ 1. IN Chapter IV. we were occupied in surveying the causes of variation in the productiveness of labour in different ages and countries. We first distinguished and briefly analysed the conditions of man's material environment that are favourable or adverse to production; and noted the differences—whether original or superinduced by human labour—in the adaptation to human uses of the portions of land inhabited by different communities, and their bordering or intersecting rivers and seas. We then passed to consider the causes of variation in the quantity and quality of labour performed, in proportion to the number of the population supported by it. We observed the important modifications in both quantity and quality due (1) to the varying physical conditions of the labourer's existence, and (2) to the varying strength of his motives for work. We analysed the complexity of the elementary impulses that constitute the 'desire of wealth' for self and family which is undoubtedly the mainspring of industry in our actual societies; and noted the manifold and complicated ways in which the strength of this resultant impulse tends to be modified by the degree of civilisation, the political structure, the moral state, the customs and prevalent opinions of any community considered as a whole, or again by the moral and social influences predominant in special classes; and especially by the varying extent and manner in which the industrial organisation maintains the correspondence of reward to exertion. We then examined this industrial organisation in another aspect, analysing the advantage obtained by the combination of labour,—that is, mainly by the

Division of Employments,—and noting the attendant drawbacks. We further observed the great variations in the efficiency of labour that are due to intellectual conditions; partly to differences in the average technical skill of the individuals actually working; still more to differences in the development of knowledge in the community; both of the knowledge of the general laws of matter which we call ‘science,’ and of the modes in which it may be adapted to human uses, which we call the ‘state of invention’ or of ‘the industrial arts.’ Finally we have dwelt on the importance of Capital; considered either in the concrete as (mainly) an already-accumulated stock of instruments auxiliary to labour, or more abstractly as the power of directing labour to the attainment of greater but remoter utilities, through the control over the produce of labour possessed by the owners of accumulated wealth.

We have now to consider how far we can establish important general propositions as to the extent to which these different causes operate. It is to such propositions that I have desired to restrict the term “Laws of Production.” In a wider sense the mere statement of a cause of the greater or less productiveness of labour might be called the statement of a Law of Production; but the description would sound somewhat ambitious, and economists who have propounded such ‘laws’ have certainly been understood to imply by the term some definite knowledge as to the *quantity* of effect to be attributed to one or more of the different causes determining production. It should be observed, however, that the propositions thus denoted belong to two very different classes; they may be (1) abstract and hypothetical, or (2) concrete and positive. That is, they may either state (1) the amount of effect that any cause, supposed to be given in quantity as well as quality, would produce under certain supposed conditions, or *tends* to produce under actual conditions so far as it is not counteracted or modified by the operation of other causes; or they may state (2) to what extent any particular cause has been found, or may be expected, to operate either in human communities generally or in the modern civilised societies with which we are primarily concerned. It will appear, I think, in the course of this chapter, that the essential differ-

ence between these two species of laws has been sometimes ignored in the discussion of economic questions.

§ 2. Before, however, we proceed to examine in detail the chief laws (of either kind) that have been propounded by economists, it is necessary to recall those limitations to the possibility of exactly measuring the productiveness of labour, which our previous discussions on the measure of value and wealth have led us to notice. We saw that so far as the commodities which are consumed in different communities—or in the same community at different times—were different in kind, a comparison between the different amounts of produce in the two cases respectively must necessarily reduce itself to a vague balancing of utilities; and that even if commodities similar in kind were produced under such different conditions (of demand, supply, &c.) in the two terms of the comparison as to vary materially in relative value, this variation introduced an irremediable element of inexactness into any quantitative comparison of the two aggregates thus variously composed.

These inexactnesses are not generally of material importance when we are considering changes in the amount produced by any community at short intervals of time, or comparing neighbouring countries similar in industrial and climatic conditions; but they may easily become very considerable when we are trying to deal with secular variations, or to include remote countries in some wide generalisation.

We saw further that, even if our result were free from this source of inexactness, it would still have no real significance, as an answer to the question which prompts us to make the comparison, if there were any marked difference in the primary needs of the different sets of human beings whose wealth we are comparing. This latter point becomes specially important when the needs in question are considered as the needs of labourers as such. We are thus led to notice an ambiguity that is latent in our ordinary vague estimates of the productive efficiency of human beings: it is not quite clear whether we are to measure it by the total value of the commodities produced or by the excess of this over the value of what is necessarily¹ con-

¹ As we have already had occasion to observe, no sharp line can be drawn between "necessary" and "superfluous" consumption. There is a broad

sumed. The latter measurement is suggested by the analogy of the instruments—especially the living instruments—employed by the labourers; since in measuring the productiveness of useful animals we should always consider not their *gross* produce but their *net* produce, after subtracting the value of the food, &c., consumed by them. The analogy is too obvious and irresistible to be ignored; and we must admit this measurement of the productive efficiency of labourers as valid for some purposes; for instance, any employer who undertook to feed his labourers would rightly use this measurement in reckonings of his private business¹. But, for the reason given incidentally in the preceding chapter, it is not, I conceive, the measurement normally applicable in our present consideration of the matter from the point of view of the community; so far, that is, as the additional consumption which causes the additional efficiency is held to be desirable, in itself or in its results of bodily or mental vigour, as an amelioration of the labourer's life, and therefore an element of the ultimate end to which the whole process of production is a means. I shall therefore in the present chapter mean by the 'produce' of which we are to examine the laws, the *gross* produce of consumable commodities; including along with this whatever new capital may be brought into existence within the period under consideration. This latter must obviously be taken into account; as it would be absurd to regard the productiveness of labour, at any given time and place, as affected by the question whether the utilities resulting from it are immediate or remote. A certain amount of error, as was before noticed, may be introduced by including new 'producers' wealth,' compared at its exchange value

margin of expenditure which increases the productive efficiency of the persons who benefit by it, though not sufficiently to make the resulting increment of produce balance the expenditure.

The exact limits of this margin seem to me very difficult to ascertain. Who shall say precisely how much of the stimulating food and drink, commodious dwellings, expensive amusements enjoyed by the best paid class of skilled workers (barristers, physicians, men of business, &c.) contribute to the more effective performance of their functions?

¹ It should be observed that in the calculations of private employers a different measurement again has commonly to be applied; the value of what the labourer produces has to be compared not with the value of the materials of his necessary consumption, but with the wages that he is willing to take.

with directly consumable commodities; in so far as the value of the former relatively to the latter may vary from other causes than the amount of its prospective produce. But this element of possible error—which we cannot define more exactly till we have discussed the theory of value—may for the present be neglected.

Let us then, taking in order the conditions of greater or less production which have been above enumerated, consider how far we can lay down laws as to the extent to which these conditions either (1) are actually found or may be expected to operate in increasing or diminishing produce, or (2) would operate in the absence of counteracting causes.

The first class of conditions examined in Chapter IV. have not—with one important exception¹—been thought to afford material for the statement of any general economic laws. In the economic history, even in the social and political history of the human race, it is doubtless indispensable to note the different advantages and opportunities for production (including trade) presented by different countries. Thus the historian will point out how the special fertility of plains watered by large rivers, and the facilities of conveyance afforded by these rivers, furnished the decisively favourable conditions for the early establishment of large societies in China, Bengal, Mesopotamia, and Egypt; how, again, to the opportunities of communication provided in peculiar abundance by an inland sea studded with islands and invaded by peninsulas, may be attributed that development of trade in the *Ægean* and the *Mediterranean* generally which led to the *Græco-Roman* civilisation as one of its consequences. These and similar *aperçus* are of great interest and importance. But the differences in the advantages and drawbacks thus presented to human industry by man's material environment are so various and complicated, and change so continually as the power of mankind to utilise advantages or overcome obstacles grows with the development of knowledge and of social organisation; that we cannot usefully attempt to frame any simple and general quantitative statements as to

¹ I refer to the effect of limited space of land in diminishing the productiveness of the labour of the community exhibiting it—as expressed in the Law of Diminishing Returns, discussed later on in this chapter.

the various and changeful effect of these conditions on production.

Again, the gradual changes that have taken place in the economic relation of man to his environment, through its adaptation by human labour, constitute (at any rate to a great extent) merely a special case of the aid given to labour by the accumulation of capital; and will be most appropriately examined later from this point of view.

I pass therefore to consider, as causes of variation in amount of produce, the differences that are found in the quantity and quality of labour applied, in proportion to the number of the population consuming the produce. Let us take first the differences in quantity. Here I do not find that any economist has thought it possible to lay down concrete laws as to the differences or probable changes either in the proportion of workers to non-workers in civilised societies, or in the average time for which they work. A small part of the very complex influences that we noted as determining these quantities does perhaps admit of being prognosticated; we may predict, for example, that civilised society will become more definitely industrial than it has yet become in European countries, and thus the slight social discredit still attaching to labour will entirely die away; but the rate of this change and the amount of effect it is likely to produce appear to be beyond calculation.

Again, as regards the abstract laws of the relation of "amount of produce" to "quantity of labour," we have to observe that the obvious arithmetical law "the more work the more wealth" has undoubtedly to be qualified by the empirical generalisation that after a certain point, any increase in the quantity of labour performed by a man within a given time tends to be accompanied by some deterioration in its quality. But in the present state of our knowledge it is not possible, I conceive, to establish an even approximate numerical law connecting the deterioration in quality with the increase in quantity.

§ 3. Here, however, it should be observed that it is not the proportion of labour to the population supported by it that recent economists have usually considered, in investigating what they call the "Law of the increase of Labour;" but rather the increase in the total number of human beings in any country;

"The increase of labour," says Mill, "is the increase of man-kind; of population." Still it seems clear that the determination of the rate of increase in the numbers of a nation does not come *primâ facie* within the general problem of Production as I, after Adam Smith, have stated it; for, as was said, we do not consider that a nation is richer or "better supplied with" the necessaries and conveniences of life, because having more members to feed and clothe it produces proportionately more food and clothing. It is therefore not primarily because the increase of a nation's numbers involves an increase in the quantity of its labour, that we are here called upon to deal with the large controversy raised by Malthus' famous Essay on Population; but because of the relation which the Malthusian doctrine maintained between increase of numbers in a given country and decrease in the proportional productiveness of the correspondingly increased labour. Or to use the phrases that have now become familiar, the 'Law of Population' chiefly interests us from its connexion with the 'Law of Diminishing Returns.'

But the connexion of these two questions is so intimate that it seems desirable here to sum up briefly the results of the long discussion started by Malthus' essay; especially as it is not, I think, difficult at the present stage of the discussion to state these results in a form not open to attack; provided that we distinguish carefully the different propositions, abstract or concrete, that have been included in the 'Malthusian theory' by its author or one or other of his disciples. Some of these propositions when separated from the rest are mere truisms; while others, though not quite so obvious and though Malthus and other writers before and after him did good service in insisting on their importance, are yet hardly controvertible, when stated with proper qualifications.

Thus that "population is necessarily limited by the means of subsistence" is a truism: an increasing number of human beings obviously require a minimum of food, clothing, &c., increasing in proportion to the number.

The same cannot be said of the further statement that population has a constant tendency to increase beyond the means of subsistence, and is kept to its necessary level either by the

“preventive checks” of prudence, or sexual vice, or the “positive” checks of “misery” or vice; meaning by the latter the increase of mortality due to famine or to diseases caused or aggravated by insufficient nutriment, or to other largely preventible or curable diseases, or to war. This proposition is certainly not a truism: it may, however, when stated with the requisite limitations and with due explanation of the rather vague term “tendency,” be now taken as incontrovertible; however much it may have been sometimes overlooked by statesmen, social reformers and philanthropists generally. By ‘tendency,’ as Mill and others have explained, we are to understand that the proposition is abstract and hypothetical; and relates to what would happen, if the checks in question were removed, not to what may be expected to happen in the actual future of our own or any other community. The proposition, though abstract is not, of course, demonstrable *a priori*; it rests on inductive evidence: but such evidence has been adequately provided, so far at least as concerns the European races, while living in Europe (or most other countries of the temperate zone) under their existing social conditions.

As regards this portion of mankind it is now (1) hardly disputed that if all men and women, observing the rules of chastity and monogamy, married at the time of life at which, apart from prudential restraint, they were inclined to do so; were not in want of the means of subsistence; had the amount of protection from death and bodily injury which is actually afforded by the Governments of civilised Europe in time of peace; and took such measures to ward off preventible diseases, from themselves and their children, as ordinarily careful persons would take in the present state of medical knowledge; the population would double itself within a certain period. This period would no doubt vary considerably with variations of race, climate and social condition, and for the purposes of the general argument need not be exactly determined; but it may probably be taken to be something between 20 and 30 years¹.

¹ There are various difficulties in the way of determining this hypothetical period of duplication with any exactness. For instance, there seems no doubt that one considerable cause of the diminution of the population in England is the excessive mortality among the infant children of the poor; but it is very

And (2) it is hardly disputed that if this process of doubling and re-doubling were continued (in a country as thickly peopled as England, France, or Germany), the amount of subsistence obtainable in the present condition of industry would soon be barely sufficient to support the population; so that the supposed increase of population could no longer continue.

The second of these propositions involves the Law of Diminishing Returns. Before discussing this, it should be observed that the greater rapidity in the increase of population which we have supposed would involve necessarily a smaller proportion of workers to non-workers. Assuming, however, that the arts of industry were sufficiently developed to enable this smaller proportion, duly aided by instruments, to provide adequate nourishment, clothing, &c., for the whole population, and that no greater proportion of the produce of labour took the form of luxuries; it is evident that if the productiveness of labour did not diminish, the increase of population might go on until it was checked by non-preventible diseases due to over-crowding. The Law of Diminishing Returns, then, affirms that the productiveness of labour does tend to diminish, as the number of labourers to a given unit of land increases, after a certain degree of density of population has been reached. The degree of density, it should be observed, varies with the development of the industrial arts, and the accumulation of capital: it tends to be removed continually further back by the progress of Invention, provided that through the accumulation of capital, the improvement of processes which Invention renders possible is actually realized. The necessity of thus limiting the scope of the law of diminishing returns to communities of a certain density, was conclusively shown by Carey, and is now

difficult to say how far this is due either directly or indirectly to the difficulty of obtaining subsistence—that is, either to diseases arising from inanition, or to the neglect of mothers distracted from the care of their children by the necessity of making a livelihood. Similarly, the extent to which either “vice” or “prudence” actually diminish our population can only be roughly guessed. Accordingly in the numerical estimate given in the text I have allowed a large margin on either side of the 25 years which I find given as the accepted average time required for population to double itself, during a long period of gradual colonisation, in the United States and Lower Canada (allowing for immigration).

generally recognised. In fact, in a thinly-peopled country we have to enunciate a Law of Increasing Returns; every additional labourer tends to make labour on the average more productive, since he enables the whole body of labourers to realize more fully the advantages of cooperation. And this tendency to increasing returns continues to apply, in all branches of industry except agriculture and mining, without any limit from density of population, except such as arises from sanitary considerations. The closer human beings live to one another, the greater tends to be the *quantum* of utility derived from a given *quantum* of labour in conveyance and communication; the greater, therefore, tends to be the development of cooperation by exchange; and as the scale on which each particular branch of manufacture may be profitably organised becomes thus proportionally larger, the production itself tends correspondingly to become more economical, as has been already explained¹.

Hence the Law of Diminishing Returns may be used both in a narrower and in a wider signification; and there is some danger of confounding the two. It may either mean (1) that the productiveness of agricultural and extractive labour tends, *ceteris paribus*, to diminish with every increase of population, even though capital increases proportionally; or (2) that, notwithstanding increased returns from the labour employed in manufactures and internal trade, the productiveness of labour generally tends so to diminish. The degree of density at which the former tendency would begin to operate is of course lower than that which would introduce the latter. Still the law, even in its wider signification, would seem to be applicable to the present condition of England and of the European countries most advanced in civilisation. There can be little doubt that in these the growth of population has passed the point at which the average efficiency of labour begins to be decreased by any addition to its quantity, other things remaining the same; that is, supposing that each additional increment of labour has about as much aid from the accumulated results of past labour as the previous increment of labour had,

¹ Cf. *ante c.* iv. § 6.

and no more; and that there is no progress of Invention, and no development of Foreign Trade. It is not of course meant that there is no possible application of labour and capital in England, according to the methods of industry at present understood, which would be more productive than some applications at present made. Such a statement would be absurd; as there is a good deal of capital actually employed which is yielding no return at all. What is meant is that, *ceteris paribus*, any considerable increment of capital-aided labour, *applied with average skill*, would be less productive than the average of capital-aided labour actually applied¹.

But then as other things do not remain the same, as on the contrary the development of Invention, and of Cooperation through Exchange with less densely peopled countries, is continually going on, this law again is purely abstract; it describes a tendency, not a fact; a force, whose operation is counteracted by another force. The proof of the existence of this force is supplied by the greater average produce of labour, when it is equally aided by Capital, Invention and Cooperation, and employed upon less crowded land; as in our colonies, including the United States of North America. But such evidence does not enable us to lay down any concrete law, formulating the actual effect which the two forces combined may be expected to produce in determining the average produce per head for a given density of population. If indeed we excluded Foreign Trade, we might confidently affirm that no degree of improvement in industry known to us by experience could counteract the effect in decreasing the average productiveness of labour which the actual rate of increase of population in England would cause; so that the decrease in average supply must soon check the rate of increase. But then this exclusion of Foreign Trade again makes our statement purely abstract and hypothetical. Supposing Foreign Trade to go on, we have

¹ It should be observed that agricultural labour is sometimes liable to become more unproductive, in consequence not merely of the increase of population, but of a disproportionate employment of the additional labour in agriculture: e.g. through an excessive subdivision of farms. But in this case the loss in productive efficiency is not entirely due to the law of diminishing returns; but partly to the defect of an industrial organisation too inert to respond adequately to a change in its circumstances.

to decide whether the region whose production we are examining is to include all the mutually trading countries or only one. But on neither view can we frame any definite concrete 'law of diminishing returns,' applicable to a country like England; on the former view because the population of the whole region with which England trades cannot be said to have reached the point at which returns diminish; on the latter view because the possibilities of England's obtaining additional subsistence by trade have only a remote and indefinite limit. If the dream of Free-Traders were realized, if all the world were willing to allow free ingress to our manufactures, it seems to be quite possible that the whole of England might become almost as thickly populated as Middlesex, without any decrease in the average productiveness of her labour.

All therefore that we can affirm is (1) that actually the proportional returns to capital and labour in England are less than they would be if England were less densely populated; and (2) that they tend *ceteris paribus* to be decreased by any increase of population, even if capital is increased proportionally. The question then remains, How far under these circumstances is population likely to increase? This brings us back to the more strictly 'Malthusian' law which affirms that the population of countries like England would increase at a decidedly more rapid rate than the present, were it not for the operation of either the prudential or the positive checks. This statement, as I have said, is hardly now disputed, by competent persons, as regards the European race in Europe. But there is an ambiguity in the phrase "prudential restraint" which it is important to point out. Prudence, in this application, means the foresight and consequent avoidance of danger; but Malthus' disciples have not always made it clear whether the danger to which they referred was the danger of being in want of the necessaries of life (for oneself or one's children), or the danger of being in want of comforts, decencies, or luxuries. It is obvious that the motive which actually restrains all classes in the community above the lowest is fear of the latter, not the former danger. It is necessary to premise this before considering the concrete law which some writers have preferred to give as the main Malthusian doctrine: the

proposition, namely, that "population presses closely on the limits of subsistence." In a certain very important sense this proposition is generally true and generally admitted in respect of civilised and fully-peopled countries; in the sense, namely, that population increases when the means of subsistence increase in such a way as will enable the mass of society to obtain an ampler supply of necessaries. From this, however, it cannot be absolutely inferred, that even the lowest class in the community is on the verge of starvation; but only that they are in a position in which the supply of food is an important element in the consideration whether or not it is prudent to marry. And since an increase in the supply of necessaries is under ordinary circumstances accompanied by an increase in the supply of comforts and luxuries; in so far as the increase of the population takes place in any of the classes above the poorest, it is to be attributed to the latter kind of abundance rather than to the former.

Still, it may be stated as a concrete law that holds good in England and other European countries, that there is a compression exercised on population by the difficulty of procuring the necessaries of life. The compression is not rigid: in England for example population might easily increase with greater rapidity than at present, if all classes restricted their consumption of luxuries—especially harmful luxuries. But a strong elastic pressure undoubtedly exists. If any statesman or philanthropist cherished the somewhat old-fashioned aim of increasing the population, the best course he could adopt would be to promote the increase of the average means of subsistence¹,

¹ The term "increase of the means of subsistence" is not free from ambiguity—any more than the term "increase of wealth" has been found to be so. For instance, the question may be raised whether the substitution of a cheaper for a more expensive food is to be considered such an increase; supposing that it is abundant in proportion to its cheapness. According to the view taken in c. iii. of the measure of wealth we should not say that the nation was enriched by the change; but, if the cheaper food were equally adapted to support life,—or even if it were merely more adapted in proportion to its cost—I should certainly say that the nation must be regarded as having more command over the means of subsistence; and that the change constituted a distinct gain in utility. Economists who have taken the opposite view appear to have assumed the proposition combated in the next section; namely, that the classes consuming the cheaper food would necessarily "people down" to the thus lowered limit of

especially of the mass of the population; since, though this is not the only means by which population can be increased, it is a means that may be relied on as effectual; and it is the only means that can be adopted without bringing the population nearer to the danger of the varied sufferings entailed by insufficiency of food.

But it is one thing to affirm that if subsistence increased, population would increase also; it is quite a different thing to maintain that the latter increase will in all cases be sufficient to absorb the former. This is what some economists who have written after Malthus—notably Ricardo—have generally assumed: and the assumption has considerable importance in the latter's system, as it is the foundation of the doctrine of a 'natural rate of wages' which occupies a cardinal position in his theory of distribution; and to which attention has recently been attracted by Lassalle and other German Socialists, under the ominous name of the "iron law of wages¹." We shall have occasion to refer to this again when we come to distribution. Here I may point out that Ricardo does not fall into the error of supposing—as Lassalle and others appear to have understood—that the "natural rate" of wages is that which gives the labourer only the bare necessaries of life. It is true that he sometimes incautiously uses language that suggests this meaning; as when he says that "the natural price of labour is that price which is necessary to enable the labourers, one with another, to subsist and perpetuate their race²." But he elsewhere repeatedly recognises that the natural price of labour "essentially depends upon the customs of the people," or "the

subsistence. Even if this consequence followed it would not necessarily involve any suffering, though it would undoubtedly increase the danger of suffering from any accidental diminution of income; because the consumers of the dearer food would under certain circumstances have the resource of descending to the cheaper article, which would be wanting to those who had already performed the descent. But, as I urge in the next section, there is no necessity to suppose that the consumers of the cheaper food cannot raise their standard of living; and if they do this they will not only have more present command over the conveniences of life, but also—on the whole—more security as regards the future, than they would otherwise have had.

¹ "Ehernes (bräzen) Löningsetz."

² This passage and those afterwards quoted are all taken from the same Chapter (V.) of Ricardo's *Principles of Political Economy*.

“quantity of food necessaries and conveniences become essential “to them from habit;” adding that “many of the conveniences “now enjoyed in an English cottage would have been thought “luxuries at an earlier period of our history.” This last sentence shows further that he did not regard “the natural price “of labour estimated even in food and necessaries, as absolutely “fixed and constant.” On the contrary he is careful to state that “it varies at different times in the same country;” and he speaks of the effort to raise it, by “stimulating the taste of the “labouring classes for comforts and enjoyments,” as one of the worthiest aims of philanthropy. But he did, I think, assume that a mere increase of subsistence had in itself no tendency to produce this effect; that even though the “market rate of wages” were to “remain for an indefinite period above the natural rate” the latter would not during this period be tending constantly upwards towards the former. At any rate this assumption seems to be involved in the main part of his reasonings on wages. It is however, as J. S. Mill has pointed out, contradicted by historical facts¹; and I may perhaps add that it is equally contrary to what our general knowledge of human nature would lead us to infer. Mill’s own view is that a temporary increase in subsistence does tend to raise the standard of comfort regarded as indispensable by the class of manual labourers, provided it is “sufficient to make a great change in their condition—a change “such as will be felt for many years, notwithstanding any “stimulus which it may give during one generation to the “increase of people.” He holds, however, that “it is a much “more difficult thing to raise than to lower this standard of “comfort;” from which proposition it is an immediate inference that, assuming the average efficiency of labour to be stationary, and casual fluctuations in supply to take place as much in one direction as in another, there would be a steady tendency downward in the standard of comfort, until the limit of bare necessaries was reached—except so far as the labourer’s prudence

¹ Mill refers (II. c. xi. § 3) to the improvement in the condition of the labouring classes in France caused by the Great Revolution. He also quotes Malthus’ statement (*Princ. of Pol. Econ.* p. 225) that a “decided elevation in the “standard of the comforts and conveniences of the English working classes” had been caused by the unusual succession of fine harvests in the fifty years from 1715 to 1765.

admits of being increased by education and other intellectual and moral influences.

Whether this be true or not, a point which I do not myself feel able to decide, it may be pointed out that here again we have a purely hypothetical proposition: since the arts of industry, and the adaptation of the earth's surface for productive purposes, are in a rapidly improving condition; and by their means more and more distant sources of supply are continually opened to the inhabitants of any particular crowded country. Hence any concrete law as to the tendency of the standard of comfort to rise or fall, must involve a forecast of the rate of progress of the improvements above-mentioned.

§ 4. We thus arrive at the question which remains to be discussed, in order to complete the enquiry proposed for the present chapter; viz. whether we can determine the laws of variation in the efficiency of labour. So far as the *personal* efficiency of the labourers is concerned, no economist (I believe) has ever claimed to possess the knowledge required for this task. Indeed it seems evident that any one who attempted to explain the differences in the physical, intellectual and moral qualities of labourers, and in the motives presented to them by their social and industrial circumstances, sufficiently to enable us to predict even roughly the future operation of these conditions, must in fact claim a prescience of the whole development of civilized society, beyond the pretensions of the most confident of living sociologists. While, again, the ultimate causes of these differences are so complicated and their effects so intermingled, that it does not seem easy to lay down any really important quantitative statements even as to the hypothetical effects of any given changes; as for instance changes in the labourer's habits of diet, or in the educational machinery applied to them, or their social customs and opinions, or the terms on which they usually cooperate.

The case is different with that element in the productiveness of labour which depends on the aid afforded it by capital; since Mill and others do undertake to give the "law of the increase of capital." It appears to me, however, that in so doing they have presented a somewhat one-sided view of the process of accumulation of what I have called 'concrete capital;'

i.e. instruments and other intermediate results of labour employed for remote ends. They have rightly pointed out that—at least in civilized communities as actually organised—this accumulation depends chiefly on the saving of individuals. But this saving can only take effect in aiding production so far as instruments or processes have been discovered by which labour may be made more productive through delay in its final result of consumable commodities. Or, to use a current phrase, there must be a ‘field for the employment of capital’ if profit is to be gained; and the existence and continual enlargement of this field depends on Invention—in the extended sense in which I have before used the term to include all improvements in the general organisation of industry, as well as in special industrial processes.

Now I conceive that no important quantitative generalisations can be established as to the variations in this second factor of the growth of concrete capital. We have no means of predicting the rate at which either our knowledge of the laws of nature or the application of this knowledge to industry is likely to progress in the future; it may be very much more rapid and extensive than it has been even during the last hundred years; on the other hand it may be very much slower, or may even come almost to a standstill—putting out of sight the possibility of any such social disturbances as might lead to an actual retrogression in civilisation. And it is further to be observed that even if we could predict roughly the amount of improvement which the industry of the future may be expected to receive from invention, it would still be quite uncertain how far this improvement will involve the enlargement of the field of employment for capital. Hitherto, inventions have generally had the effect of complicating and prolonging the processes of industry, while at the same time increasing the ultimate productiveness of labour. But this has not always been the case; and so far as I know, there is no reason why the inventions of the future should not be chiefly in the direction of simplifying and abbreviating industrial processes; so that at each step of improvement the demand for capital will be restricted instead of being enlarged¹.

¹ Cf. *post.* B. II. c. vi.

It remains to ask, whether we can ascertain the abstract law of the other factor in the growth of concrete capital; whether, supposing the field of employment for capital determined, we can say how far the capital will be furnished. Now the applications of labour, in the making of instruments or otherwise, by which its ultimate net production is increased, are of varying degrees of profitableness; the increment of produce obtained by delay is in some cases greater, in others less. We have therefore to ascertain (1) how far the community can afford to labour for remote results, and (2) so far as it can afford this, for what amount of economic gain it will be willing to postpone immediate consumption. And since, as we have seen, in a society organised on the basis of private property, this postponement is principally brought about through the saving of private individuals, an important part of the problem presented will be solved, if we can determine the law according to which the amount of this saving tends to vary.

The first point is to ascertain the amount of the fund from which saving can be made. This takes us back to the distinction drawn in § 1 between the net produce of labour of the community and its gross produce; since the fund available for saving is obviously the former and not the latter. What can be produced by any society in any given period, over and above what is required to supply the necessaries of life to all engaged in production, and to compensate for the deterioration of the previously existing capital, gives the maximum of possible saving within the period. As we have seen, the line between "necessary" and "superfluous" consumption cannot be sharply drawn; and it is the less necessary to attempt to draw it with precision, since the maximum above indicated has never been approached in any community of human beings; the dispositions which prompt men to save having always proved weaker than the dispositions which prompt them to spend, long before this maximum was reached. Still, so far as we limit our investigation to cases where we may assume that the primary needs of the human beings considered are an approximately constant quantity¹, we may clearly lay down that

¹ This assumption is often manifestly untrue when we are comparing the productive efficiency of different races. E.g. the reason why the competition of

the possible maximum of saving increases as the gross produce of labour (per head) increases, but in a greater ratio. Hence, if the resultant forces of the impulses that prompt men to save as compared with those that prompt them to spend could also be assumed to be constant, the accumulation of capital—when it once had fairly commenced—would tend to increase at a continually accelerated rate.

But this latter assumption is manifestly too divergent from facts to be useful. The tendency to save, like the tendency to spend, is the complex result of a number of different impulses, some self-regarding, some sympathetic; and continually varies, partly in proportion to the strength of these, partly from variations in the intellectual condition of human beings and partly from external causes. Even if we suppose the desires that aim at the personal enjoyments derivable from wealth to remain unaltered; any important change either (1) in the prospects of security afforded by the physical or political circumstances of the community, or (2) in the average individual's power of foresight and capacity of being moved to action by the representation of remote consequences, or (3) in the range or intensity of his sympathetic interests, especially those due to family affection or patriotism local and general, must affect materially the general disposition to save. Now no economist, so far as I know, has attempted to determine the laws of variation of these conditions. In fact, the only general "law of the increase of capital"—beyond a mere statement of the above-mentioned conditions of variation—that Mill¹ (c. g.) appears to lay down, is the abstract proposition that, other things being equal, the "effective desire of accumulation" will vary directly with the "pecuniary inducement" to accumulate; that is, with the rate of interest². Thus, other things being the same, if the

"Chinese cheap labour" is so menacing to the English race in America and Australia seems to lie in the smaller necessary consumption of the average Chinaman, as compared with that of an average Englishman; which renders the net produce of the former's labour greater, though the gross produce is less.

¹ Book I. c. xi.

² In this passage, as in another quoted soon after, Mill appears to use the terms 'interest' and 'profit' as practically convertible, though he elsewhere carefully distinguishes them. This does not seem to me contrary to usage; as 'profit' is I think often used in a wide sense for all 'returns to capital,' so as to

rate of interest falls, the supply of new capital on which the interest will have to be paid will tend to be less: if it rises more. This abstract proposition is probably true on the whole; but even this seems to me less simple and certain than Mill represents it, since the total effect of a fall in interest is the result of a number of tendencies which to an important extent act in contrary directions. So far, indeed, as a man is induced to save not by the desire to attain any particular definite end, but by a general estimate of future resources as compared with present enjoyments for himself, his family, or others whom he may wish to benefit, it is obvious that any diminution in the yield of his savings must *pro tanto* decrease this inducement. But it would seem that in most cases the motives for accumulation are not of this general character. In the first place men in business and the professions save, to a great extent, with a view of obtaining a certain income from their savings; the amount of which they conceive beforehand with more or less definiteness, whether their aim is to retire from business themselves or to provide for their children. It is obvious that a lowering of the rate of interest, as it would render a larger amount of saving necessary to obtain a given income, would have a certain tendency to *increase*—instead of decreasing—the amount annually saved by such persons. Again a large amount is annually saved, especially by poorer persons, not so much for the sake of the interest as in order to have the principal “against a rainy day:” all such saving will be scarcely include as one species ‘interest,’ which always denotes the additional wealth continually obtained by the mere ownership of capital, or the price paid for the temporary use of it by the employer of capital who does not own it. Still, it seems to me more convenient, when we are endeavouring to ascertain as precisely as possible the law of the increase of capital, to distinguish the terms as English economists ordinarily do; and to denote by ‘profit’ the yield of capital to the employer who is also the owner. If this distinction is taken, it will evidently be ‘interest’ rather than ‘profit’ which supplies the motive to accumulation, in the case of all persons except those who employ their own capital; and it will be so even as regards these latter, so far as they are able to borrow what they can profitably employ in their business at the ordinary rate of interest, allowance being made for risk. Hence it seems to me best to use ‘interest’ exclusively in the present discussion; though it ought to be borne in mind that so far as an employer believes that he could advantageously use capital that he is not able to borrow at the ordinary rate, he will have an additional stimulus to save.

at all affected by any change in the rate of interest. Further, we have to take into account the great influence of habit and social custom in determining the apportionment of income between expenditure and accumulation. Many persons have a nearly fixed standard of living, and so long as their income is more than sufficient to provide for this, they merely save the surplus whatever it may happen to be. In proportion as this is the case, their saving will only be diminished by a fall in interest so far as their income is diminished by it: and it is in no way necessary that a fall in interest should be accompanied by a decrease in the average income of individual members of the community. In fact, as Mill points out, "a fall in the rate of interest is frequently itself the result of a great accumulation of capital; and the income derived from a large amount of capital at a low rate of interest generally gives a greater total power of saving than the income derived from a small amount of capital at a high rate of interest."

It appears, therefore, that a fall in the yield of capital is likely partly to diminish the inducements to save, partly to increase them, partly to influence saving in a manner which we cannot precisely determine till we know the special causes of the fall. I think it probable that the first of these effects will generally preponderate over the others; but I do not think that we can say that this will certainly be always the case, still less to what extent it will be so.

On similar grounds I should regard as rather too dogmatic Mill's subsequent statement¹ that "there is at every time and place some particular rate of profit which is the lowest that will induce the people of that country and time to accumulate savings and to employ those savings productively." That is, I see no *a priori* reason why accumulation and productive investment should not go on, so long as such investment is found to yield—on the average and after making full allowance for all losses—any interest worth considering. If a man were distinctly more likely to lose than to gain on capital invested

¹ Book iv. c. iv. Here again Mill must evidently be understood to use the term 'profit' as convertible with 'interest;' since in another paragraph he speaks of a "profit or interest of 3 or 4 per cent" as being "a sufficient motive to the increase of capital in England at the present day."

he would probably prefer to hoard his savings in some form; though it must be remembered that any mode of hoarding would involve some degree of risk, and some trouble or outlay or both. But I do not see why accumulation should not go on as at present with average net interest barely above zero: and I think it possible that it may so go on at some future stage in the world's history. I think however that if the fall took place in a community in an intellectual, moral and social condition similar to that of England at the present time, accumulation would come to an end at a much earlier point, though the exact point at which this could take place seems to me impossible to determine¹.

§. 5. But even if the laws of the saving of individual members of any community, within any given period, could be determined more precisely than appears to me to be the case, there are several reasons why the result would give us no exact

¹ In connexion with this conjectural forecast the following point should be noticed. The new savings of individuals are partly absorbed by sales of capital already invested by persons who wish to spend some of their capital: the saving of one set of people being thus balanced by the spending of others. Now in what has been said we have supposed that the community is adding to its real capital, and therefore that some part of the savings of individuals have to take the form of new instruments of industry. If, however, the rate of interest falls through this accumulation of instruments, such previously existing instruments—especially land—as have not had their utility impaired by the competition of the new capital, will (as we have already observed) have their selling value increased; and therefore the sales of such instruments by persons intending to consume the proceeds will absorb a continually increasing amount of savings. This consideration becomes important when we forecast the consequences of a continual fall in the rate of interest. Its effects will be most easily shown by making an extreme supposition. Let us suppose that, owing to the steady increase of savings, more rapidly than the enlargement of the field of employment of capital through invention, &c., interest by 1950 *A.D.* has fallen to a third of its present rate in England; and that rents on the average have been doubled through the increasing scarcity of land. It is obvious that land will sell at six times its present price; and therefore the sale of any given portion will be capable of absorbing six times the amount of saving that it would absorb at present. And if we carry the supposition of a fall in interest still further, it will be evident—still assuming rents at least not to fall in value—that before saving could increase to such an extent as to make the interest on capital merely cover risk, so that investment was no better than hoarding, the value of land must have become infinite. And the same may be said of the value of any irredeemable perpetual annuities that may have been sold by governments or private corporations.

guidance as to the increase of the productive resources of the community within the period.

In the first place—if we mean by a “community” a single nation, and not the whole aggregate of human beings more or less united through exchange into one industrial organisation—it should be observed that communities may, and in modern times largely do, lend their capital to other communities instead of employing it themselves; so that the supply of new capital for home employment may be reduced, without any fall in the rate of interest, merely because more attractive openings for investment have presented themselves abroad. Of course this foreign investment of capital increases the share obtained by the community of the produce of the world’s labour; but it does not increase the productiveness of the labour of the community, except in an indirect and uncertain way, so far as it extends the opportunities and increases the advantages of foreign trade.

But secondly, even if we confine our attention to home investments, it is easy to see that the amount of individuals’ capital employed profitably for the owners, but not so as to make the labour of the community more productive, may vary greatly, without any variation in the average effective desire of accumulation of the individual members of the community; in consequence of physical or social emergencies, imposing large occasional outlays on the community as a whole. In modern times this is most conspicuously exemplified by the large loans of governments for purposes of war; the issue of any such loan, while it tends to raise the current rate of interest, tends also to reduce the amount of capital contemporaneously invested for industrial purposes. Thus a large amount of the ordinary savings of the community may be absorbed, and the aggregate capital of individuals correspondingly increased, without any real increase in social capital¹.

But again, even if we contemplate only capital productively

¹ It may be observed that in the same way the occasional needs of a portion of the community may absorb the savings of the rest, so that the additions to capital within a given period may be much less than usual, or even non-existent, without any alteration in the average force of the motives that prompt to saving.

employed, it is evident that the profit of any investment of savings to the individual investing is a very uncertain measure of its advantage to the community. For the investment may destroy or reduce the utility of previously invested capital; as when a railway is constructed which takes away traffic from an already existing railway, or a shop with expensive front, fittings, &c., is successfully designed to attract custom from another shop. The progress of invention, which continually modifies the field of employment for capital, continually affords opportunities for fresh investments—as in newly invented machinery, &c.—inevitably tending to reduce the value of portions of capital already in existence, to an extent which, so far as we know, may vary indefinitely. Improvements may easily be imagined which would annihilate vast portions of the productively invested wealth of individuals; such (*e.g.*) as a mechanical invention that superseded railways in England, or a development of trade that rendered English wheatgrowing unprofitable; and economic changes of this kind, though smaller in degree, are continually occurring. In such cases, then, the gain to the community from the new investment has no definite relation to the interest earned by the investing individual; it may be obviously much less, when we take into account the destruction of the utility of the previously existing capital.

On the other hand, it is equally possible that it may be much more. For the social profit of an improvement in the instruments of production can rarely or never be entirely appropriated by the individuals who use the improved instruments. How much of this gain they can secure is a question which it properly belongs to the theory of distribution to answer; but we can see without refined analysis that so far as producers using better machinery are forced by competition to reduce the price of their products below what was required to remunerate the less efficient production which they have now superseded, the gain of the improvement goes to the consumers of these products and not to the owners of the capital as such. And, as I have before observed, any improvement in processes which does not increase the whole amount of capital employed benefits society without making any room for new savings—except at the expense of previously existing capital.

At the same time, as a set off against the depreciation of previously existing capital in consequence of the progress of industry, it should be borne in mind that durable results of previous labour productively applied, so far as they are protected by circumstances from competition, may become continually more valuable as the community which purchases their products becomes more civilised and more populous. This may either be due to an actual increase in the amount of commodities they are enabled to produce, or merely to an increase in their price; in either case it constitutes an addition to the value of existing capital not due to saving, and of which the amount is not determined by any cognizable law.

Further, we have to take note of the large amount of results of labour for remote ends, more or less profitable to the community, which are not included in the "saving" of individuals as ordinarily estimated; and which come but vaguely and slightly (if at all) within the operation of the law of such saving, as above formulated. Under this head will come a large amount of the improvements of agricultural land under a system of small farming (especially if the cultivator be also the owner); the utility of such land is increased by the extra labour of the cultivator, which—though of course performed for the sake of profit—is not regulated by any definite consideration of the current rate of interest. Still less is such a consideration operative in determining the accumulation of the durable wealth that we have called "consumers' capital;" so far at least as such wealth is commonly owned by the persons using it. It is true that in societies where security of property is imperfectly maintained, savings are often to a large extent invested in jewels and gold and silver ornaments; but this is for the convenience of concealment or transportation, and not with a view to profit. Again in more civilised communities, persons who accumulate ornaments or works of art are sometimes partly influenced by the prospect of reselling them at a higher price hereafter; and even apart from this prospect the purchasers of such things may be to some extent more inclined to buy when interest is low than when it is high; but the influence of this consideration on the whole accumulation of consumers' capital would seem to be very slight and vague.

Again, a large part of the labour for remote results, that is spent in utilising the opportunities continually presented for the successful establishment of new lucrative businesses, can be but slightly affected by changes in the rate of interest;—not to speak of the very partial and varying extent in which such results are a gain to the community, even when they are a definitely valuable and vendible property to the individual who enjoys their advantages. Further, we must not leave out of account the increase of social resources due to labour from time to time expended in founding and developing institutions of public utility—educational, sanitary, and the like—by which no profit is earned for individuals.

And, finally, along with these latter, though vastly above them in importance, we must reckon the economic advantages of the greatest of human institutions, the State; in building up which so much toil and other sacrifices have been incurred for distant results, from motives of patriotism or love of glory, without any reckoning of pecuniary returns to the individuals who have laboured. A statement of the Laws of Production is undeniably incomplete without an attempt to estimate systematically the economic benefits and drawbacks that spring from different political institutions and different principles and methods of administration. It seems however most convenient to defer all consideration of the tendencies of different modes of Governmental interference, until in the concluding book we come to discuss these tendencies from the point of view of Art or Practice; and ask ‘How far (if at all) and in what way *ought* Government to intervene with a view to making the ‘produce of industry a maximum.’ The answer to this question will indirectly supply an answer to the corresponding question that we should naturally here raise from the point of view of science; so far, that is, as it seems to be within the province of the theoretical economist to deal with this latter enquiry.

BOOK II.

THE THEORY OF DISTRIBUTION AND EXCHANGE.

CHAPTER I.

INTRODUCTION.

§ 1. WE have now to consider what, in accordance with usage, I have given as the second part of the subject of economic science: The theory of Distribution and Exchange. Before attempting to expound this theory, it will be desirable, in order to avoid misunderstandings, to define carefully the subject of investigation.

We may begin by removing an ambiguity in the term 'distribution.' According to the view of Production generally taken by the earlier economists, in which only material products were contemplated, 'Distribution' would naturally suggest the consideration not merely of the shares in which the aggregate of these products was divided among the different classes of consumers, but also of the actual process of conveying them in different directions from the place in which they had been manufactured, and retailing them to the final purchasers. But according to the view taken in the preceding book, in which the commodities furnished by carriers and traders are considered as a part of 'produce,' this meaning of 'Distribution' is obviously inappropriate; and by most recent economists (in England at least) the term has been understood, as I shall exclusively use it, to denote the division of the aggregate produce of the industry of any society among the independent¹ individuals who, personally or otherwise, have cooperated in producing it.

¹ 'Independent' is inserted to exclude the *domestic* division performed by each head of a family among those dependent on him. It also excludes, generally speaking, all eleemosynary distribution; though in some cases— as for instance in investigating the minimum below which wages cannot permanently fall—the effects of almsgiving, and of public provision for paupers, have to be taken into account.

Secondly, it should be observed that it is not strictly the Distribution of Wealth, but the Distribution of Produce¹ or Real Income with which we are primarily concerned. We suppose a society individualistically organised, in which the main part of the land and other instruments for producing wealth are already distributed among the members as their private property. This pre-existing distribution of producers' wealth we do not profess to explain; nor is it absolutely necessary, up to a certain point of our investigation, to make any general assumption with regard to it. It is however most convenient to conceive it to resemble in its general features the facts of all existing civilised societies: to suppose that some persons own land and some capital in varying and sometimes considerable amounts, and that others have little or none of either; and that in neither case are the owners and the users altogether coincident.

Again, we have already noticed that certain portions of consumers' wealth—such as land and buildings, pictures, statues, jewels and other ornaments, some kinds of books and furniture, &c.—are comparatively durable, and are only slowly and accidentally destroyed or deteriorated in the using. A large part of this, as well as of producers' land and capital, has in civilised countries been handed down from father to son for many generations; and it is obvious that the manner of its distribution at the present time cannot be explained even approximately as the result of abstract economic laws. We may doubtless trace to a certain concurrence of causes the amount of land devoted in England to purposes of amusement, in the way of parks, gardens, &c., and the division of this land among the descendants of the old nobility and gentry and the sons or grandsons of merchants, stock-brokers, brewers, bankers, &c.; but the study of these causes cannot well be separated from the study of the general history of English society.

It is further to be observed that the utilities derived from this durable consumers' wealth have not commonly been included by economists in the aggregate of which they investi-

¹ 'Produce,' that is, as defined in c. vi. of the preceding book: it might be called 'Net produce' from the social point of view, though not from the point of view of capitalist employers.

gate the distribution. But, obviously, they must be taken into account in estimating the command, either of individuals or of the community generally, over the necessities and conveniences of life within any given period. As was before said, the shelter and other satisfactions that a man derives from his house,—however long it may have been built—must be regarded as a part of the real income obtained from his capital. It is true, at the same time, that such utilities cannot for the most part¹ be included in the ‘produce of industry’ during the period subsequent to the building of the house, &c.; and the amount of them enjoyed by any individual owner of Consumers’ Capital will not be affected directly by any changes in the rate of interest that may occur within the period. Still, as was before observed, so far as the use of such durable products is hired, it is commonly paid for out of the *money* income of the person hiring, and must therefore be included in our conception of his *real* Wages, Profits, &c.: and it would be obviously inconvenient to include these purchased utilities in the produce distributed, and to leave out of consideration others precisely similar in kind, merely because they happen not to have been purchased: especially since, during the period investigated, important changes may take place in the comparative extents in which such durable products as houses are hired or owned by the users².

Further, for completeness of view, just as we include in the purview of our Theory of Distribution utilities derived from pre-existing capital, which are not exchanged nor in any ordinary sense distributed during the period that we contemplate; so, on similar grounds we must also take account of the unpurchased utilities that a man derives from his own labour or the unpaid labour of members of his family; at least so far as the labour is of a kind that might—and under other circumstances would—be employed in producing saleable commodities, whether mate-

¹ That is, except so far as they are due to the labour required from time to time for repairing and keeping in good condition houses and other kinds of durable consumers’ wealth.

² It should also be observed that the exchange value of such utilities will be modified by any changes in the exchange value of the products that afford them, during the period investigated.

rial or immaterial. Of this kind, for instance, is the labour of cooking food, making or repairing or cleansing clothes and furniture, teaching children, carrying purchases from shops, and walking to and from places of work: when we contemplate the resulting utilities from the point of view of the community, we find that a portion of them, varying at different times and places, is commonly purchased, and another portion of them commonly unpurchased; hence it would be manifestly misleading to confine our attention to the former, and to leave the latter entirely out of sight.

A varying portion of this unpaid labour is employed in appropriating and utilising those "spontaneous gifts of nature" which at certain times and places are unpurchased (except by the labour of appropriation, &c.) while elsewhere and at other times they command an extra price through scarcity. We have already seen¹ that in comparing the wealth of different societies at different times and places we must include these unpurchased utilities in one term of the comparison, if utilities of the same kind, having exchange value, are included in the other terms; and the same principle will obviously apply to the comparisons that have to be made, in considering changes and differences in distribution.

It is, however, the produce of purchased labour and Producers' Capital (including land) to which our attention will be primarily directed: including under the term "produce" all purchasable commodities, whether "embodied in material objects" or not. This extension of the meaning of "produce" was suggested and defended, though not fully adopted, in the preceding book: where we saw that the ordinary distinction between "products" and "services" is not only difficult to draw, but apparently based on superficial considerations irrelevant to our present enquiry. Our object is to study the causes of the different extents of command over "necessaries and conveniences," obtained respectively by different members of the community, through the complicated system of co-operation by means of exchange, on which the life of modern society depends; and since some portion of each one's money income is spent in purchasing not material wealth but education, professional

¹ B. I. c. iii.

advice, &c., we must regard these utilities, no less than the material products of industry, as practically 'distributed' through the medium of the money payments that determine the nominal incomes of individuals: and the laws that govern the exchange values of these immaterial commodities concern us as much as those regulating the values of material products.

Finally, I must remind the reader that this produce must not be conceived as consisting entirely of consumers' wealth (or other utilities). We have seen that in a society that is growing richer, a certain portion of this new wealth will be continually saved and added to the already existing accumulation of capital. This portion need not necessarily have existed at all in the form of consumers' wealth; indeed it is simpler to regard the greater part of it, in such a community as ours, as originally 'produced' in the form of new railways, docks, warehouses¹, &c.; but such additions to industrial capital must none the less be regarded as part of the produce distributed; so far at least as they are more than sufficient to compensate for the continual destruction, deterioration, and depreciation, of capital.

In a community in which capital is decreasing, produce as so defined will be continually exceeded by consumption. In most cases this result presents no special difficulty for our consideration; such a community will naturally and rightly be regarded as in a position analogous to that of an individual who is living beyond his income. But this conception would be misleading in the exceptional case in which the decrease of the capital of individuals is the effect of an industrial improvement. This case we will discuss more fully in a subsequent chapter; meanwhile, to avoid any difficulty, it will be convenient to suppose the community contemplated to be one in which industrial capital is steadily increasing.

With these explanations, we may state as follows the main question which our Theory of Distribution attempts to answer: 'According to what laws is the increment of new valuable com-

¹ Though, as was before said (B. I. c. v.) it is a legitimate and for some purposes a convenient fiction to suppose the investing capitalist to pay real wages to the labourers employed in making the new instruments; and accordingly to consider the invested 'savings' as having first existed in the form of food and other commodities consumed by the labourers.

modities, provided by the labour and capital of the community 'within a given time, shared among the different classes of persons, who either by their own exertion mental or bodily, or by allowing the use of their property, knowledge, or other resources, have co-operated in providing it; so far as the terms of co-operation are determined by free bargaining among persons seeking each his private interest?' This last proviso indicates that our theory is only applicable in a partial and qualified manner to societies in which the prices of products or services are to any considerable extent determined by law, custom, or current opinion as to what is just or equitable. It also excludes from our present consideration the important share of the produce appropriated by Government, so far at least as concerns the transfer of this from the possession of individuals to that of the state, by means of taxation. The redistribution, however, of the collected taxes among the members and employes of Government, and in the way of governmental expenditure, proceeds to a great extent by free contract, and is similar in its determination and effects to the distribution through free contract of the rest of the produce.

The different shares of this latter are distinguished and classified in ordinary discourse as (1) Wages of labour, extending the term to include what are more commonly called the Earnings or Salaries of the higher kinds of labourers; (2) Profits of persons employing labour together with capital and sometimes land; (3) Payments for the use of borrowed land and capital, further distinguished as (a) Rent paid for land and buildings, and (b) Interest¹ paid for the use of 'money,' as is commonly said, or of 'capital,' as economists generally say.

Without at present attempting a more exact demarcation of these different shares, it is easily seen that each share represents the price paid by society for a certain service or utility contributed by the recipient of the share. In the case of Wages, Interest, and Rent, this fact is obvious without the least analysis; since Wages are paid directly for Labour, Rent for

¹ 'Interest' is commonly used to include all annuities paid in return for capital formerly borrowed, even when there is no obligation to repay the principal: and it may conveniently be extended so as to include all annuities legally secured to their recipients.

the use of land, and Interest for the use of money or other capital. A little more reflection is required to see the exact nature of the utility remunerated by Profits. The profit obtained in any year by a man of business is only ascertainable indirectly by taking the value of his capital (including land) at the end of the year, adding what he has taken out of his business from time to time for consumption, and subtracting the value of his original capital. In many businesses the result of this calculation will vary very greatly in different years; sometimes, doubtless, falling considerably below zero. Still we may assume that, on the average, the profit obtained by a business in which a given amount of capital is employed must be materially greater than the interest that could be got by lending the same amount; and that the labour and thought required for the management of capital is not given to society gratuitously by men of business as a class. This excess, then, of average profit over possible interest (and sometimes rent) is to be regarded as the price which society pays for the employer's labour; and we may call it, after Mill, the employer's Wages of Management¹.

It appears, then, that in all cases the different shares of the produce are obtained by what is, substantially if not formally, an exchange of certain services for the price that they will fetch; so that the Theory of Distribution will be in fact a Theory of the Exchange Value of these services. It is in order that this view of it may be kept prominently before the reader that I have thought it best not to follow Mill in separating it broadly from the Theory of the Exchange Value of material commodities. Mill's procedure was due, I think, partly to a view of the laws governing Wages and Profits which I shall presently argue to be erroneous; partly to a wish to lay stress on the possible—and widely actual—determination of the shares of produce not by free bargaining, but by custom. Some general discussion of non-competitive principles and modes of distribution from the point of view of Economic Science will be given in a subsequent

¹ Mill's own term is "Wages of Superintendence"; but "Superintendence" seems to me less adapted than "Management" to denote the whole of the complex function of the *entrepreneur* of a business.

chapter¹; and the subject will come before us again in the Art of Political Economy, which will be treated of in the following Book. But in the main part of the present Book I shall assume that the terms of all transfers of the use of labour, or the use of wealth, or of any other services, no less than the terms of sale of material wealth, are left entirely to free contract, unfettered either by custom or by moral considerations.

It remains to decide whether we shall examine first the remunerations of producers or the prices of products. Two considerations chiefly have influenced me in adopting the latter course. In the first place, in examining, even by a deductive method, how the prices of products are determined, we shall be dealing approximately with concrete facts, phenomena of industry admitting of statistical investigation; whereas the remunerations of different classes of productive services, as defined by economists, are, to an important extent, elements arrived at by abstract economic analysis. In a synthetic exposition of economic theory these more elementary and abstract notions would properly be taken first; but since it is a chief aim of the present treatise to eliminate unnecessary controversy by carefully expressing the reserves and qualifications which the abstract reasonings of Political Economy require, it seems most convenient to proceed analytically and begin with the more concrete and complex facts. But I have also another more occasional reason for commencing with the theory of the exchange value of the different articles that make up the aggregate which we call wealth. In dealing with this question I am able to work on the lines laid down by Mill and to take his exposition as the basis of my own: while in explaining the corrections and additions which appear to me necessary to rectify and complete his statement on this subject, I shall also to a great extent explain what I regard as the more radical defects of his Theory of Distribution.

I shall therefore occupy the two following chapters with an examination of the laws according to which the Exchange Value of material commodities tends to be competitively² determined.

¹ See chap. xii.

² I have adopted this phrase as a convenient abbreviation for "determined under the influence of free competition."

The value of Money will require a separate discussion, as the definition of the term Money has first to be carefully considered. Accordingly, the fourth and fifth chapters will be occupied respectively with the Definition of Money, and the theory of the Value of Money; from which latter subject we shall pass by an easy transition to the determination of Interest, with which, in the sixth chapter, the exposition of the Theory of Distribution will commence.

NOTE. Mr Walker, in his instructive book on *The Wages Question* (chap. I.), states that "vast amounts of wealth are exchanged which are not distributed; vast amounts are distributed which are not exchanged." I am not here concerned to dispute the latter of these propositions; but the former seems to me to imply a misleadingly narrow view of Distribution. Mr Walker gives as an example the case of a small American farmer, proprietor of a farm in one of the Southern sea-board states, for which he and his family supply all the labour required. He says that all the cotton produced on such a farm is "not distributed," though it is "exchanged, "being sold to purchase breadstuffs, clothing, West-India goods, &c." The cotton, no doubt, is not distributed *by* the farmer; but I conceive that the breadstuffs, clothing, &c. are properly regarded as distributed *to* him. They constitute his share of the aggregate produce of the industrial society of which he is a member; a share which increases or diminishes, according as the value of the service rendered by him to society in producing cotton rises or falls—that is, as compared with the services rendered by the producers of breadstuffs, &c. And similarly, of course, the cotton sold by him will be distributed through exchange among other producers.

CHAPTER II.

THEORY OF EXCHANGE VALUE OF MATERIAL COMMODITIES.

§ 1. THE main assumptions on which English Economists since Ricardo have generally proceeded, in their investigations of the laws of value, have been briefly discussed in an earlier chapter¹. But before examining the theory in detail, it will be desirable to state these assumptions again somewhat more fully; because, although the actual facts of industry correspond to them approximately, the degree of approximation varies very much in different cases.

1. We assume that every person concerned in the production or exchange of the article in question aims intelligently at selling his goods or his services at the highest price which he can get for them; neither Law nor Custom nor Philanthropy intervening to modify his endeavour. When this assumption is stated in its most general form, we must understand 'price' to mean 'balance of total advantages obtained by the transaction over any drawbacks that may be incident to it.' But, generally speaking, in the sale of material products, the only drawback is the expense of forwarding the article to the buyer (so far as this is undertaken by the seller) which may be simply subtracted from the price; while the advantages, with one important exception, are wholly comprised in the money-price of the article. The exception is that a dealer frequently has an interest in dealing with one class of purchasers rather than another, with a view to the establishment of a business. But within large limits it is in most cases true that any differences among purchasers are indifferent to the seller of goods, except

¹ Introduction, c. iii.

so far as one offers a higher money-price than another; and it will be convenient in the following discussion to confine our attention to such cases¹.

The assumption above stated would often be briefly signified by saying that we assume "perfect competition:" but the phrase might be misleading, since I do not necessarily assume *open* competition in the sense of excluding any combination of dealers. Such a combination merely places the aggregate of dealers in a position analogous to that of a single monopolist of any article, and our theory treats, as a separate case, of the determination of value under the conditions of monopoly: and since under certain circumstances it is the interest of each and all of a group of dealers to enter into such a combination, it would be an arbitrary limitation of the subject to exclude it.

2. But, except so far as Monopoly comes in, we assume that the competition of dealers in a market is perfectly free and open, the prices at which transactions actually take place being readily ascertainable by all dealers; and that, in consequence, at the same time and place wares of the same quality are sold for approximately the same money-price. Strictly speaking, we have no ground for assuming this identity of price, except where the quantities sold are approximately the same; since the trouble of the seller, the remuneration of which is included in the price, does not vary materially with the amount; so that we should expect a reduction of price for large transactions. And in fact such a reduction is actually made in certain dealings both wholesale and retail. E.g. it is partly on this account, partly from the importance of business connexion, that large dealers commonly sell to the retailers of their commodities at a price lower than that charged to purchasers for consumption. But in wholesale transactions among dealers it is generally convenient to have a fixed price (per unit) for all amounts in which it is worth while to deal at all; and for simplicity's sake we will confine our attention to transactions where this is the

¹ On the other hand, where the commodity sold is labour and the sale involves the local transfer of the labourer's residence, the drawbacks thence resulting are generally somewhat more than the mere trouble, expense, and loss of time entailed by the transfer. This has been sometimes overlooked in the deductive determination of wages.

case. We shall assume, therefore, that 'the market-price' of which we speak is at any given time and place the same *per unit* for all quantities sold. The market need not necessarily be at one place; only if it extend over a considerable space, the price cannot be assumed to be strictly the same, but the same allowing for expenses of transport.

3. We further assume that the products whose price we are investigating are made solely to be sold; and not partly for the consumption of the producer. In the existing organisation of industry, the extent to which any producer supplies his own consumption is trifling in most industries; and so far as the case is otherwise, we may conveniently avoid complication by the fiction of supposing the producer to sell to himself at the market-rate whatever share of his own products he and his family consume. Only wherever this share is a considerable proportion of the whole, as is sometimes the case with small agricultural producers, it must be borne in mind that the same individuals have to be regarded in two aspects at once, as producers and consumers; and that their gains in the latter character will partially counterbalance any losses through cheapness that may befall them in the former character.

4. A minor deviation from facts which it is convenient to make is the assumption that variations in price are continuous. In reality, of course, the difference between the different prices per unit cannot be less than the smallest current coin; and thus the minimum of change in large transactions may be considerable, if the customary unit of sale be comparatively small. In proportion as this is the case, any changes in the forces determining value have to reach a corresponding amount before they can take effect on actual prices.

5. Besides assuming perfect competition among traders—or, to use Cairnes' phrase, perfect "commercial competition"—we also assume the existence of "industrial competition," within the region contemplated. That is, we assume that labour and capital are *mobile* or capable of being attracted, by a higher rate of remuneration, both from district to district, and from industry to industry; so that not merely are the wages paid for the same quality of labour in any one industry approximately the same; but also when the remunera-

tion of labourers or capitalists in any industry is known to be higher than that of labourers or capitalists in some other industry entailing no more sacrifice or outlay and requiring no scarcer qualifications, the difference tends to be gradually reduced by the attractions which this higher remuneration exercises on actual or prospective labourers or employers. The extent, however, to which this tendency may be assumed to operate, without deviating too widely from actual facts, will require careful discussion.

The theory of market values or prices, as determined by Supply and Demand, depends on the assumption of Commercial Competition (so far as combination is excluded): while the theory of "natural" or "normal" values or prices, so far as they are determined by Cost of Production, depends on the assumption of Industrial Competition:

§ 2. J. S. Mill, in the third book of his *Political Economy*, Ch. I--VI., has lucidly explained the manner in which the operation of these two quite different kinds of competition is combined. This explanation, in spite of the sweeping attacks that have been made upon it, still appears to me in the main sound, so far as it goes, though requiring to be qualified, supplemented, and corrected; and for this reason, considering the wide popularity of Mill's treatise, it seems to me convenient to take his statement as the basis of my own exposition.

I will begin by giving a summary of the theory, as nearly as possible in Mill's own words¹:

"The temporary, or Market Value of a thing, depends on the demand and supply; rising as the demand rises, and falling as the supply rises. The demand, however, varies with the value, being generally greater when the thing is cheap than when it is dear; and the value always adjusts itself in such a manner, that the demand is equal to the supply.

"Besides their temporary value, things have also a permanent, or as it may be called, a Natural Value, to which the market value, after every variation, always tends to return; and the oscillations compensate for one another, so

¹ This summary is partly taken from Mill's own summary in his *Book III. c. vi.*, partly from passages in the preceding chapters of the same book.

“that, on the average, commodities exchange at about their “natural value.”

In considering the determination of this natural value, we have to distinguish three classes of commodities. First, there is a “small class of things which, being limited to a definite “quantity, have their value entirely determined by demand and “supply, save that their cost of production (if they have any) “constitutes a minimum below which they cannot permanently “fall.” Secondly, there is a “large class” of things which can be produced in [practically] indefinite quantity at the same proportional cost of production. The value of such things “does “not depend (except accidentally, and during the time necessary for production to adjust itself) upon demand and supply; “on the contrary, demand and supply depend upon it.” Such things “naturally exchange for one another in the ratio of their “cost of production, or at what may be termed their cost value :” that is, a value “sufficient to repay the cost of production, and to “afford besides the ordinary expectation of profit (regard being “had to the degree of eligibility of the employment in other “respects). There is a demand for a certain quantity of each “commodity at their cost value, and to that the supply in the “long run endeavours to conform;” through the desire of capitalists to make the highest possible profits, which causes capital to be continually withdrawn from less profitable and invested in more profitable industries. Nor is it necessary, in order to make the value of a thing conform to its cost of production, “that its supply should actually be either increased “or diminished.... The mere possibility often suffices; the “dealers are aware of what would happen, and their mutual “competition makes them anticipate the result by lowering “the price.”

Finally there is a third class of commodities “which have “not one but several costs of production; which can always “be increased in quantity by labour and capital,” but only at a continually increasing cost. The natural value of such things is “determined by the cost of that portion of the supply which “is produced and brought to market at the greatest expense :” the relation of natural to market value being similar to that existing in the case just discussed.

Further analysis shews that "Cost of Production consists of several elements, some of which are constant and universal, others occasional. The universal elements of cost of production are, the wages of the labour, and the profits of the capital. The occasional elements are, taxes, and any extra cost occasioned by a scarcity value of some of the requisites.

"Omitting the occasional elements; things which admit of indefinite increase, naturally and permanently exchange for each other according to the comparative amount of wages which must be paid for producing them, and the comparative amount of profits which must be obtained by the capitalists who pay those wages.

"If two things are made by the same quantity of labour, and that labour paid at the same rate, and if the wages of the labourer have to be advanced for the same space of time, and the nature of the employment does not require that there be a permanent difference in their rate of profit; then, whether wages and profits be high or low, and whether the quantity of labour expended be much or little, these two things will, on the average, exchange for one another.

"If one of two things command, on the average, a greater value than the other, the cause must be that it requires for its production either a greater quantity of labour, or a kind of labour permanently paid at a higher rate; or that the capital, or part of the capital, which supports that labour, must be advanced for a longer period; or, lastly, that the production is attended with some circumstance which requires to be compensated by a permanently higher rate of profit."

The critical exposition of the theory above summarized, which I propose to conduct in the present chapter, may be conveniently commenced by removing some ambiguities in the cardinal terms used in stating it. In the first place, I ought to explain that I shall generally substitute the term 'price'—which, when used without qualification will always denote 'value in money'—for the more abstract term 'value' which Mill prefers; believing that the greater familiarity and

definiteness of the notion of 'price' will render it easier for the reader to follow the reasonings of this chapter. This use of Price for Value requires us to suppose that the purchasing power of money relative to commodities in general—exclusive of the one whose value is investigated—remains unchanged: but no material error is introduced by this supposition at the present stage of our discussion.

Secondly, the reader should bear in mind that in the notion of Cost of Production we include the cost of bringing to market the product in question. In investigating the prices of the products of International Trade we shall also take note of the further expenses that may have to be borne by the seller or the purchaser of the product, in conveying the equivalent of the commodity sold back from the market to the place where the seller wishes to use it. But this consideration may be omitted in dealing with commodities produced in the country in which they are sold: to which in the present chapter we may conveniently confine our attention.

Further, the term Demand requires careful definition, if it is to be used with quantitative precision. On this point Mill's language is not quite as clear as could be wished. He tells us that by "Demand" he means the "quantity demanded" of a commodity, and that this "in general varies according to "the value," decreasing as the value rises and increasing as it falls. On the other hand he tells us that the "value rises as "the demand rises;" but what is meant by the demand—i.e. the quantity demanded—"rising," except "increasing?" and how can it be consistently said (1) that the quantity demanded increases as the value falls, and (2) that the value rises as the quantity demanded increases? To remove this apparent inconsistency some further explanation of the two statements seems desirable. To begin with the first proposition: in affirming that 'the demand for a ware increases as its value rises,' we are considering the changes that would take place in the quantity demanded of any product, if the price charged for it rose or fell in consequence of the action of the sellers, while the consumers' estimate of its comparative utility remained the same. We assume that for any given price there is a certain amount which purchasers are willing to take at that price; and that so long as

all else remains unchanged this amount will be greater when the price is lower, and less when it is higher. What the exact extent of any such variation in demand will be, for any given change in price, we have no means of knowing *a priori*¹, and we make no general assumption with regard to it. All that we assume is that for every rise [or fall] in the price of a commodity, other things remaining the same, there will be a decrease [or increase] in the amount of it which can be sold at the price. This assumption, as Mr Thornton has pointed out, is not found to hold in all sales that actually occur; it may easily happen that at a particular time and place a moderate change in the price of a given ware would not alter the number of persons willing to purchase it. None the less is the assumption, I think, perfectly legitimate as a scientific hypothesis for the purposes of general deductive reasoning. It is as simple as possible: it represents with approximate accuracy the most important facts with which the theory is concerned, viz., those of wholesale trade universally, and to a great extent those of retail trade and other exchanges, so far as regards commodities largely dealt in by purchasers of various degrees of wealth; and, finally, whatever theory we frame by means of this assumption will be easily modified afterwards so as to suit the less important cases in which the assumption is partially inadmissible.

Mill, then, in his account of Demand, contents himself with accepting the general fact that people will buy somewhat more of an article as it becomes cheaper and somewhat less as it becomes dearer. But we certainly gain a clearer and completer view of value if we go further and find an explanation of this fact in Mr Jevons' theory of the relation of Exchange Value—or, as he prefers to call it, the "ratio of exchange"—to "value in use"² or "utility²." In the view of Mill (and, I believe, of

¹ We may observe that these variations, in the case of most articles, are included within certain limits. That is, if the price rose beyond a certain point people could not afford to purchase the commodity at all; and if it fell to zero, the demand would still remain finite. But as the changes that actually occur fall considerably within these limits, we are not called upon to take account of them.

² These two terms are not exactly equivalent: for as we have seen "value in use" implies (just as "exchange value" but less definitely) a comparison of the

all English economists before Mr Jevons) the only connexion between "value in use" and "value in exchange" is that the former fixes a superior limit to the latter; since I shall never give *more* for a thing than I believe it to be worth to me, though the competition of sellers may enable me to get it for much less. But—as we have already observed¹—it is implied in the general relation between Demand and Price as above stated that some part of what is sold at any price cannot have a higher "value in use" to the purchasers than its exchange value. For the slightest rise in price, would make some of them buy a little less: hence the "value in use" to them of just this small margin of their purchases, which they would refrain from buying at a higher price, must be estimated by them as about equivalent to its exchange value. In Mr Jevons' phrase, the price of any ware represents the Final Utility of the total amount sold, as estimated by the purchasers generally.

It must be borne in mind that, owing to the unequal distribution of wealth, the same price represents very different degrees of utility in relation to different purchasers. If the price of a newspaper were reduced from 2*d.* to 1*d.*, two men, one rich and one poor, might be thereby induced to take it in; but the 1*d.* would represent a much higher estimate of its value in use on the part of the poor man. In fact, the quantity demanded of a commodity at any given price is the casual outcome of a number of very diverse estimates of its final utility made under indefinitely varying conditions. And hence, while it is interesting to see that each variation in demand, corresponding to a change in price, is generally a compound effect of a number of different readjustments of these estimates (rendered necessary by the change in price), it seems unimportant, for the general theory of exchange value, to investigate further its relation to value in use. It is, no doubt, of the greatest importance, in practical applications of economic theory, to ascertain as far as possible the law of variation of the demand for each particular

commodity valued with some other. But as it is only with comparative utility that Mr Jevons' theory is concerned, the difference is here unimportant.

¹ I. c. 3 § 2.

commodity: and in doing this careful consideration of the different classes of the purchasers who buy it, and of its probable value in use to each, may help us greatly in interpreting or supplementing the information supplied by trade statistics. But for our present purposes we may be content with the broad and general statement before given of the correspondence between variations of Demand and variations of Price.

So far, then, in speaking of the relation of Demand and Prices or Value, we have been supposing a Law of Variation in Demand—what we may call for brevity a Law of Demand—to remain unchanged; and have been explaining its general character. But when we speak of ‘price rising as demand rises,’ we are contemplating the effect not of a given Law of Demand, but of a change in such a law. We are supposing that owing to some change in social needs or desires, or in the supply of some other commodity, or perhaps in the general wealth of society, a new law of demand has come into operation, and the amount of the commodity demanded at any given price has increased. This effect, supposing the supply of the commodity to remain unchanged, is commonly expressed by saying that “the Demand is in excess of the Supply.” But this being so, according to our general assumption of a continuous variation in demand corresponding, but in an opposite direction, to any variation in price, there will be some higher price at which the demand will be equal to the supply; it is obviously the interest of the sellers to raise their price till it reaches this point, and the competition of the buyers will enable them to raise it.

It thus appears that the phrase “increase of demand” is ambiguous; since it may either signify (1) the increase in quantity demanded which would result from any fall in price, the law of demand remaining unchanged, or (2) an increase in the quantity demanded at any given price, resulting from a change in the law of demand. The phrase is, I think, more ordinarily used in the second meaning; still it seems well to have two unambiguous terms to distinguish these very different facts; and I think it will be in accordance with usage to speak of the former always as an *extension* of demand, and of the latter always as a *rise* in demand. I shall therefore always

use these terms so; and similarly I shall use "reduction" and "fall" as the opposites of "extension" and "rise" respectively.

It ought to be borne in mind that not only may the demand for any one commodity vary quite differently from the demand for any other, but also that the demand for the same commodity may vary differently at different times. In fact, the law of variation of demand for any given commodity is doubtless continually varying, as the amount of wealth in any community, the manner of its distribution, and social customs and fashions change. But, for simplicity's sake we will assume, where the contrary is not expressly stated, that the law of demand for each of our commodities remains unaltered, during the period that enters into our consideration.

§ 3. Assuming then that the price of, and demand for, any commodity vary together continuously but in opposite directions according to a certain law, it is evident that for any given quantity of the article "supplied" or offered for sale, there will be some price at which (to use Mill's phrase) "the equation of demand and supply" would be realised—that is, at which the quantity demanded by purchasers in general would be just equal to the given quantity. Hence this equation, according to Mill's theory, will fix the market-price of the article; and in the case of a monopolised or scarce commodity the natural or normal price will be similarly determined. And no doubt the combined self-interests of sellers and buyers must tend to produce this result, if the quantity of the article supplied were fixed independently of its price, and had to be sold at any price that could be got for it. But it is obvious that this will not ordinarily be the case; in fact, as Mill himself points out, demand and supply are frequently equalised, not by an extended demand resulting from cheapness, but by "withdrawing a part of the supply." But he does not seem to see that, on this supposition, his solution of the problem of value is formally incomplete. If the quantity supplied varies with the price, as well as the quantity demanded, there may, so far as Mill's statement of his theory goes, be any number of different equalisations of supply and demand for the same article, corresponding to different prices.

It is rather remarkable that Mill should not have noticed this theoretical possibility; since he has drawn attention to a similar possibility in connexion with his theory of international values, and endeavoured—though not very successfully—to meet the difficulty thence arising. At the same time it is true that under ordinary circumstances, in the cases which Mill has chiefly in view, there is but one price at which the Demand and Supply of any article tend to be equalized: and it is further true that the manner in which the supply at this price is theoretically determined is very simple. Still, it seems desirable to investigate more fully the influence of Price on Supply: not only for the sake of theoretical completeness, but because the cases in which a simple answer is not sufficient are hardly so exceptional as Mill seems to have supposed.

In making this investigation, it will be convenient to consider first commodities belonging to Mill's first class, of which the Natural no less than the Market Value is stated to be determined by Supply and Demand. These are commodities of which the supply is insufficient to satisfy the whole of the demand that would exist for them at their cost value. Mill¹ says that such things are at a "scarcity" or "monopoly" value. He thus uses as convertible, two terms which I find it necessary to distinguish; since it makes an important difference in the determination of the value of a scarce article, whether its supply is (1) controlled by a single seller, or several sellers who combining act as one, or is (2) in the hands of several sellers, competing freely with one another. It will be convenient to use the term "monopoly" to imply the former state of things, and to call the latter case that of simple "scarcity." It should be observed that a monopolized article will not necessarily be scarce: since a man may control the sole supply of any ware and yet be unable to sell it at a price exceeding the cost value: indeed it may easily happen that he has to sell it for a lower price still, as is the case (e.g.) with the authors of unreadable books. But we need not here concern ourselves with a monopoly of this unprofitable kind.

¹ Following Adam Smith,

§ 4. Let us then begin by considering how supply will be determined in the case of a profitable monopoly. Here it soon appears that the effects of monopoly on value are very different under different conditions. There are some monopolized commodities for which the demand is keen, while the whole amount that it is possible to produce is very limited, and the additional expense of production involved in producing a larger amount instead of a smaller, is comparatively small. In the case of such commodities, the decrease in price required to extend the demand sufficiently to meet any possible extension of supply will never be so great as to make the total profit on a larger quantity, less than the total profit on a smaller. E.g. if the average produce of the Johannisberg vineyard were increased by one-half, without any decline in quality, it would be necessary to lower the price a little to get all the vintage sold off; but it would not be necessary to decrease it by nearly so much as one-third, so that (allowing for the additional expense of production), the net revenue of the proprietor of the vineyard would be considerably increased. In all such cases, then, the law of supply is very simple: since self-interest will lead the proprietor of the commodity to produce and offer for sale as large an amount as he can. But these are not the ordinary conditions of monopoly. It more commonly happens that the supply of the monopolized article is easily capable of being increased to an extent unprofitable to the monopolist: because in order to produce a corresponding extension in the demand, he would have to lower the price so far as to decrease his net revenue. Under these circumstances it is obvious that his interest will lead him deliberately to limit the supply to some definite amount. It is not quite so obvious, but it must be evident on reflection, that the law of variation in the demand, may be such as to make it equally his interest to limit it to each of several different amounts. Take (e.g.) the case of the publisher of a new book likely to be tolerably popular. The expenses of production in this case will be partly the same however many copies are printed, and partly proportional to the number of copies. Let us suppose that they will amount to £100 and one shilling per copy. It is clear that he will gain the same net amount of £100 whether

he sells an edition of 500 at 9s., or of 1000 at 5s., or 2000 at 3s.; and it is quite possible that the demand may be of such a nature, that it would take off each of these three editions in about the same time. Thus there will be no economic reason¹ why the publisher should choose one of these numbers rather than either of the other two: the "equation of supply and demand" may be established indifferently at any of the three different values. And the same may of course be true of any number of values, in the case of any monopolized commodity of this class².

So far the articles considered have been luxuries; for which the maximum price obtainable is closely limited and could not exceed an amount small in proportion to the whole resources of the purchasers. But it is quite conceivable that an article absolutely necessary to subsistence might be thus monopolized; in which case the possible pecuniary gain of the monopolist, on the assumption of perfect commercial freedom, would theoretically amount to the whole spare wealth of the region affected by the monopoly. In practice, no doubt, the fear of popular indignation or legal interference would generally keep the monopolist's charges far below this theoretical maximum.

§ 5. Let us now consider the case of what I have called "simple scarcity value;" i.e. where the scarce commodity is sold by a number of persons who do not combine. Here, generally speaking, the amount of supply will be practically settled by the dealers selling all that they can bring to market. But it may happen, as in the case of strict monopoly, that if each individual seller aimed intelligently at obtaining the greatest possible profit, and were able to rely on an equal exercise of enlightened self-regard on the part of all the rest, each would artificially limit his supply yet further; and the smaller the number of dealers, the more this is likely to be the case to a material extent. Here too the same maximum of profit might conceivably be attained by any one of several different limitations. We must observe, however, that these

¹ For simplicity's sake I have not taken into consideration the gain in the way of connexion that would probably accrue from selling the larger amount.

² Some further remarks on the different modes and degrees of monopoly will be found in a subsequent chapter (c. x.).

limitations will generally be different from those of a strictly monopolized commodity. For a point at which it is the combined interest of the sellers to stop the supply, if only each could rely on all the others doing the same, will generally be a point at which it is any individual seller's immediate interest to add to his supply; since the fall in the price of his commodity caused by this addition will generally be more than compensated by the profit on the extra amount that he sells; although (*ex hypothesi*) this would not be the case if he had to share this profit equally with the other sellers.

Let us suppose, for instance, that there are two springs of mineral water of the same quality, possessed and worked by two different persons. Let us suppose¹ that the necessary expense of working each spring is £50 a month (including ordinary profit on the capital laid out in the original purchase) and that the expense of bringing to market each additional dozen bottles of the water may be estimated at 1s. Let us suppose the demand to be of such a kind that 500 dozen bottles a month can be sold for 9s. 6d. a dozen, but that the price must be lowered to 5s. to take off 1000 dozen a month; while if the supply were increased, as it might be, to 1500 dozen, the price per dozen would have to be reduced so much that the gain on the additional amount sold would not compensate for the loss on the rest. Under these circumstances it would obviously be more profitable for the two, if they could act in concert, to produce only 500 dozen a month: as in this case they would divide an extra profit of £112. 10s. ($500 \times 8s. 6d. - £100$), while if they sold 1000 dozen they would only divide £100 ($1000 \times 4s. - £100$). But if there is no concert between them, it will not be the interest of each to limit his production to 250 dozen: for if either were to do this it would obviously be the interest of the other to increase his own production to 750 dozen; since by that means he would gain an extra profit of £100 ($750 \times 4s. - £50$), while it would be a matter of indifference—or even satisfaction—to him that his rival's extra profit was simultaneously reduced to zero.

Hence, where there is no combination among the sellers,

¹ For the convenience of readers, I have taken the figures so as to correspond as closely as possible to those of the previous example.

self-interest without concert will prompt each and all to enlarge the supply until it reaches the point at which each would immediately lose by going further. Indeed—as I before said—I think that in practice such sellers would be likely to go beyond this point, and to sell as much as they can. For though each would immediately lose somewhat by so doing, his own loss would be much less than the loss he would inflict on the rest; since the price would fall for all alike, while he alone would be partly compensated by his profit on the extra amount he sold. On the other hand, if one seller were mistakenly to limit his supply, he would injure himself alone, while slightly benefiting his rivals. Under these conditions, the coolest self-interest would be likely to err in the direction of extending supply; so that each would probably find it better on the whole to guard against the danger of such error on the part of others, by extending his own supply: so long, that is, as it remained at a scarcity value. Hence in the case of a scarce article sold under free competition, the equation of supply and demand is practically likely to be realized by the simple process of selling the whole supply¹ for what it will fetch.

In the preceding examples I have supposed that the monopolized or simply scarce article has to be produced at a certain expense, which I have taken to be partly a constant quantity, partly a quantity simply proportioned to the whole amount produced. But, in order to represent approximately all actual cases, other suppositions would have to be made. For instance, we must take account of the case of finished products of which the supply is absolutely limited, such as old editions of books or the pictures of deceased artists. Here reasonings similar to the above may be used; only simplified by the omission of expenses of production. So again, in the case of monopolized products of agricultural or extractive industry, the cost of production will generally increase in a greater ratio than the amount produced. In this case the calculations of a monopolist aiming at the maximum of gain would be somewhat more

¹ I imply in using the term "scarce" that the supply cannot be increased so much as to bring down the price of the article to the point to which it would fall if it could be produced in unlimited amount.

complex than those above given; but they would be framed on similar principles.

§ 6. Let us pass to consider how the market-price will be determined in the case of Mill's second and (as he says) "large" class of commodities: those of which the supply can be indefinitely increased by labour and capital, the cost of production for any given amount remaining the same. We have seen that what Mill calls the "natural" price of any such commodity—(i.e.) that to which its market value is always tending to approximate—is, in his view, very simply determined: since industrial competition must tend to prevent the price of any such article from being, in the long run, either *less* or *more* than is just sufficient to repay the cost of its production, including average profit on the capital employed in producing it. Assuming for the present that this cost of production is definite and known, there is obviously but one price that satisfies this condition, which Mill therefore calls the "cost price:" accordingly, industrial competition tends to keep the quantity supplied just equal to the quantity which people wish to buy at this price. But the market price at any particular time may be above or below the natural or cost price; and the exact point which it at any time reaches in its oscillations is determined entirely, as Mill says, by Supply and Demand. But how precisely will it be determined? This question requires a careful answer; since it is clear, as was said, that the quantity offered will depend on the price as well as the quantity demanded: dealers are continually decided to sell or hold their stocks by the price prevailing in the market. If such dealers can at any time combine, they may manifestly secure a temporary monopoly of the article, so that its market value may be determined in the manner which we first investigated. But under the more ordinary conditions of open competition the determination is quite different; and it will be convenient to consider this case first.

Let us assume in the first instance (1) that production and consumption continue at a uniform rate through the year, and (2) that the commodity is not one that will deteriorate through being kept. Then, if we take any single dealer who has a stock of the commodity, we see that he will gain by selling it,

unless he has reason to expect that the price at some definite distance of time will be higher than the present price by an amount more than sufficient to compensate him for his loss of interest or profit¹ on the capital locked up in the unsold stock together with the expense and trouble of taking care of the goods. Hence, if we suppose that all the dealers have full information and perfect foresight, and that none of them would have to pay more than ordinary interest on borrowed money, we may infer that competition will keep the price at the point at which there is equal expectation of advantage in selling or holding back: i.e., at which any expected rise in prices is estimated as just sufficient to compensate for expense and loss on the stock kept back. Thus, so long as the price at any time is raised above cost price, these hypothetical dealers will sell all their stocks, unless they foresee in the proximate future a rise in demand more than sufficient to counterbalance the increase of supply² which the high price will tend to cause. If, on the other hand, the market-price should fall below cost price, owing to a temporary over-production, the action of the dealers in keeping back supply will check the fall at the point at which the difference between cost price and market-price is estimated as about equal to the probable loss on the stock kept back, during the time expected to elapse before the price rises again to cost point. Such would be the result under the simplified conditions that we have supposed; and such will tend to be the result, in proportion as these conditions are approximately realised in practice. But actually, of course, the supply that is kept back in any market partly depends on differences of opinion on the part of different dealers as to the future prospects of supply (or demand). It also depends, to a perhaps greater extent, on differences in another condition in which the theory

¹ Whether the dealer will require to be compensated for loss of interest merely, or for loss of profit, depends upon the condition of his business. If he does not see his way to using money profitably in his own line of business, he will only consider that he has to be compensated for loss of interest: but if business is flourishing, he will consider that he could be earning traders' profit on the money locked up.

² This increase may be caused either by stimulating production within the area from which the market in question has previously been supplied; or by extending this area, and attracting supplies from more distant producers.

as above given assumed uniformity. We have spoken of "loss of interest" as if there were a uniform rate of interest for all dealers; but it commonly happens that any trading body includes dealers in very different pecuniary circumstances, and some who would have to borrow at a higher rate than others. Hence these dealers will gain by selling off their goods at a price at which others will gain by keeping them back.

It may be observed that, under our hypothetical conditions, a rise in the general rate of interest will tend to increase the oscillations of market-price, by rendering it more difficult for dealers to keep back supply. A similar effect will be produced by any liability to deterioration in an unsold commodity. In an extreme case the deterioration might be so inevitable and rapid that it would never be the dealer's interest to keep any part of the supply longer than a single day; in which case the price would always tend to be fixed so that the day's demand should take off the day's supply.

Finally, the same general principle—that supply will on the average tend to be held back to an extent just sufficient to repay the loss of interest involved in holding back—will enable us to solve the slightly more complicated problems presented by commodities of which the supply and demand are not uniform and continuous. Suppose (e.g.) that an article is produced only in one part of the year, while the demand for it is uniform throughout the whole year, as is the case with the chief agricultural products. Here the competition of producers and dealers will tend to adjust the supply actually brought to market so as to keep the price throughout the year nearly but not quite uniform; a slight rise being necessary, as the time of completion of the last harvest recedes into the past, in order to compensate for the interest lost by keeping produce unsold—apart from any further rise or fall that may be caused by good or bad expectations of the coming harvest. But here again we shall find considerable deviation from this result in practice, on account of differences in the knowledge, foresight, and pecuniary circumstances of different dealers.

§ 7. So far I have not expressly adverted to the effects of speculative sales and purchases. But in fact, in discussing the problem of market-value in its more abstract and simplified

form, it was tacitly assumed that the legitimate work of speculation, in reducing the fluctuations of price that would otherwise result from fluctuations of supply and demand, would be completely performed without any special class of speculators; through the enlightened self-regard of ordinary dealers, prompting them to hold stocks when the price fell and sell when it rose. And of course, even under the conditions of actual business this assumption is largely realised; and, so far as this result of speculation is concerned, the only consequence of the development of a special class of speculators is that—as in other cases of division of labour—the work is likely to be more expertly performed. But the question still remains, how far speculation tends normally to produce only this moderative effect. According to Mill, this is necessarily the case so far as the speculators themselves profit by their operations. He admits, of course, that these have sometimes the opposite effect of causing or aggravating fluctuations: but he holds that, whenever this happens, the speculators themselves are the greatest losers. Thus he concludes that “the interest of the speculators as a body coincides with the interest of the public;” and “they can only fail to serve the public interest in proportion as they miss “their own”¹.”

If we exclude the supposition of monopoly effected by combination among the speculators, this conclusion seems to me in the main sound, at least so far as markets for material products² are concerned; since those who purchase these products for use generally consider themselves as good judges of their quality as the speculators can be, and are not likely to be deluded into buying bad or useless wares through any operations of the latter. But even with these limitations Mill's doctrine is not alto-

¹ *Pol. Econ.* Book iv. c. ii. § 5.

² If the reasoning is intended to apply to actual markets for *securities*, it involves the important error of neglecting the influence exercised by the example of the speculators on a public conscious of its ignorance of the articles purchased. In such markets it often happens that artificial fluctuations in the values of sound securities, and even artificial elevations of the prices of worthless ones, when once started by speculative sales and purchases, are carried considerably further by the blind imitation of *bonâ fide* investors; and so become a source of profit to the speculators who are able to sell at the inflated, or buy at the lowered, rates which they have thus indirectly caused.

gether true; since so far as the changes in value which the speculator foresees and profits by are not alternations but comparatively permanent steps in one direction or the other, his gains are often made at the expense of the public; inasmuch as his operations do not render prices more stable, but merely antedate the rise or postpone the fall in price that would have occurred without them.

If, however, the possibility of combination be admitted, Mill's reasoning obviously fails as regards all commodities for which the demand diminishes but slightly as the price rises, so that (within the limits that we have practically to consider) the total price of the amount that can be sold at each rate continually increases as the amount itself diminishes. In the case of all such commodities it is quite possible for a combination of dealers, by buying up the whole or a great part of the stock in the market, to gain, through the high price obtained for a portion of what they have engrossed, more than enough to compensate them for any loss on the remainder. Food and other necessaries of life, as Mill himself explains, are commodities of this class. There is no doubt (e.g.) that a combination to raise the price of corn might be a source of great profit at the public expense, if only the combining dealers could secure a sufficient hold of the stock in the market, and if an outburst of public indignation against such "forestalling and regrating" did not interfere with the operation.

The famous "gold ring" in New York in 1869 is a striking instance of a successful combination of this kind: for, as all wholesale trade was carried on upon a gold basis, the metal was indispensable to solvency though not to life; while as the ordinary currency consisted of inconvertible paper, the amount of gold easily obtainable was small enough to admit of being monopolized.

§ 8. So far it has been assumed that the cost of producing the article considered is uniform, whatever changes may take place in the demand for the ware, and consequently in the amount produced to meet the demand. But how far is this assumption legitimate? In order to answer this question we require to analyse carefully the general notion of "cost of production." And first we must observe that as Mill's theory of value "con-

“templates a system of production, carried on by capitalists for a “profit,” he naturally considers cost of production from the capitalist’s point of view: that is, he regards it as consisting chiefly of the *wages* that the capitalist has to pay—either directly, or indirectly in buying instruments and materials. Against this procedure Cairnes¹ has made strong objections. He considers that “cost of production” ought to mean the “sacrifices undergone by “producers,” and that Mill’s use of the term “confounds things” so “profoundly opposed to each other as cost and the reward “of cost.” It is certainly important to draw attention to the difference between the amount of effort and sacrifice involved in production, and the amount of remuneration which this effort and sacrifice obtain: and if our theory had merely for its object to state the kind of causes which determine value, we might admit the greater clearness of Cairnes’ view. But if we profess to use the notion of cost with quantitative exactness—and such profession is certainly implied in Cairnes’ own statement that, if competition be perfect, “commodities will exchange *in proportion to their costs of production*”—we obviously require a common measure for the different elements of cost of production: as we cannot definitely think of anything being “in proportion to” an aggregate of incommensurables. Now what common measure can we find for the heterogeneous sacrifices of labourers and capitalists? How (e.g.) are we to conceive a proportion between (a) the sacrifices of twenty unskilled labourers and a capitalist employing £10,000, and (b) the sacrifices of ten skilled labourers and a capitalist employing £20,000? The only measure I can conceive is that which Mill’s theory adopts: viz the price that has to be paid for these efforts and sacrifices. That is, in Mill’s language, omitting “occasional elements,” such as “taxes, and any extra cost occasioned by a scarcity value of “some of the requisites of production,” the “universal elements of “the cost of production are the wages of the labour and the profits of the capital.” And in “profits of capital,” we must include the profits of the capitalist who finally brings the ware to market, as well as those of the other capitalists whom he reimburses in his payments for materials and machinery, or in his purchases

¹ *Some Leading Principles*, Part 1. c. iii.

of goods where they are produced¹. It is, no doubt, apparently paradoxical to include in cost of production profits that are not yet realized. But the paradox is merely apparent, at least so far as the theory of value is concerned: since it is not the actual profit, but the *expectation* of profit, which—*ceteris paribus*—determines the flow of capital to one industry rather than another; and which is thus the efficient cause of the variations in supply which raise or lower the market-price. And, as Mill explains, owing to the different periods of time for which capital lies invested in different kinds of production, this expectation of profit enters into the calculations of different capitalists in very different proportions to the remuneration of labour: so that any estimate of relative costs of production which omitted profits would be liable to serious errors.

But a more serious difficulty has to be faced. If cost of production is thus estimated in terms of *remuneration* and not *sacrifice*, it is not—at any given time—independent of demand. For any rise of demand that causes a rise in the price of an article of course increases both actual and expected profits; while again, as it generally raises the demand for the skilled labour required to produce the article most profitably, it thus indirectly increases wages. Hence we have to add, that by “wages and profits,” considered as elements of the cost of production which determines “natural price,” we do not mean the actual wages and profits in any particular case: in fact, in this sense, as Cairnes pointedly observes, wares would always exchange in the exact ratio of their cost of production: since what remains over of the price of any ware, after reimbursing outlay, is the actual profit of the capitalist who finally brings the ware to market. The rates of wages and profits that enter into the determination of natural value, must be the *normal* rates to which, under the influence of industrial competition, the wages and profits of any industry tend to approximate. But the question again arises, Can these normal rates be assumed to be independent of the demand for the product? Let us take first the case of wages. It is no doubt natural to

¹ It is a pity that Mill does not present a more decided and consistent view as to the relation of “profits of capital” to “cost of production.” Cf. c. iii. § 1, as qualified by c. iv. § 5.

suppose, that under a system of perfectly free competition no known differences in the reward of labour could be permanently maintained except such as are required to remunerate differences in the efforts and sacrifices made by the labourers; and many of the disciples of Adam Smith have followed their master in making this general assumption¹. But this is not Mill's view. He has pointed out, in a noteworthy passage², the conclusions of which Cairnes has adopted and developed, that there are important differences in normal wages, which are due to scarcities of various kinds: chiefly to scarcities arising from the unequal distribution of wealth, which limits the power of performing certain kinds of services to the minority of persons whose parents have been able to afford the expense of prolonged training and sustenance for their children. The freest competition has not in itself any tendency to remove these scarcities, unless the present inequalities in the distribution of wealth are first removed: and it seems clear that so far as the labour of any one social grade is thus purchased at a scarcity price as compared with that of the grade beneath—i.e. at a price more than sufficient to compensate, with interest, for the above-mentioned outlay on prolonged training and sustenance—the average remuneration of such labour will not tend, even in the long run, to be independent of the demand for its product³. For suppose the demand to fall. According to Mill's general theory, the decline in profits caused by such a change in demand, will reduce production until the decrease of supply restores the price of the product to a point at which the expenses of production are remunerated as before. But, in the case that we are contemplating, the decrease in production which is the first stage of this process, will involve a fall in the demand for the scarce services, and a consequent fall in their price. The amount of the fall will no doubt be ultimately much reduced by industrial competition: but the effect of the

¹ Cf. *Wealth of Nations*, c. x. first page.

² *Pol. Econ.* B. II. c. xiv. § 2.

³ Of course this division of society into grades, *within* which industrial competition is supposed to be perfect, and *between* which it is supposed non-existent, does not correspond *precisely* to the facts of modern industrial communities; but it corresponds to these facts more closely than the older hypothesis of generally effective competition.

lowered demand will still remain, though decreased in intensity by being distributed among all the labourers of the same grade: unless the lowering should happen to have been compensated by a rise in the demand for some other labour belonging to the same grade. Hence, the normal price at which the equation of supply and demand will be ultimately re-established, supposing the lowered demand to continue, will be slightly lower, as corresponding to a slightly decreased cost of production¹.

Let us now examine how the matter stands with the other element of cost of production, profit. In Cairnes' view, normal profits—unlike normal wages—may be rightly assumed to be independent of demand. "The competition of capital," he says, "being effective over the entire industry of each commercial country, it follows that so much of the value of commodities as goes to remunerate the capitalists' sacrifice will "throughout the range of domestic industry" be proportioned to that sacrifice. This statement, however, seems to me to need restriction in more than one respect. It follows, of course, immediately from the assumption of industrial competition that the profit obtained by employing capitals of equal amount cannot be permanently known to be different in different industries, except so far as the sacrifices required in any of the industries are greater, or the qualifications scarcer, than those required in the other. But economists have sometimes written as if the profits of manufacturers and traders were published in statistical tables open to the inspection of all persons desirous of employing capital. It is therefore necessary to remind the abstract reasoner that the most observant man of business can only attain

¹ It may be observed that Ricardo avoids the conclusions above given by an assumption of a different kind. He seems to have supposed, that the differences in the remuneration of different kinds of labour are fixed and stable; in which case they would of course be independent of changes in demand. "The estimation," he says, "in which different qualities of labour are held, comes soon to be adjusted "in the market with sufficient precision for all practical purposes...the scale when "once formed is liable to little variation." And no doubt, in respect of many kinds of labour, the demand for which is not subject to great and sudden changes, such fixity is often approximately maintained by custom. In any practical application of the theory of value the extent to which this is the case should be carefully noted; but to assume such fixity as normal is obviously inconsistent with the hypothesis of perfect competition.

a rough approximation to the truth, in calculating the profits made in other industries and districts; and hence that the equalizing force of competition can only be assumed to act strongly and certainly upon industries in which profits are either considerably above or considerably below the average. Within a somewhat broad margin on either side of the average its operation cannot but be vague and feeble; and hence the normal cost of production that regulates supply must be conceived as having a similar indefiniteness.

But a more important qualification of the proposition that profits tend to equality remains to be pointed out. It is commonly assumed by Mill, Cairnes, and other economists that the rate of profit tends to be the same, not only on capitals of the same amount, but also on capitals of different amounts. How far this assumption corresponds to the facts I do not now propose to enquire; but it certainly does not seem to be reconcilable with the proposition before quoted, that the remuneration of the (employing) capitalist tends to be proportioned to his sacrifice. For if not only the rate of *interest*, but also the rate of *profit* is the same whatever be the amount of capital on which it is obtained, it is obvious that the element of profit which we have agreed to call the employers' "wages of management," must vary with the amount of capital managed: but it can hardly be held that the trouble of managing varies in the same ratio. Granted that there is more labour and anxiety in conducting a large business than in conducting one of half the size; it can hardly be said that the former occupation imposes twice the amount of sacrifice. In short, if the rate of profit in any industry is really the same on large and small capitals alike, it must be because the services of large capitalists are at a scarcity value, so that they can exact from society a higher rate of remuneration for their trouble. But it certainly cannot be known *a priori*, as a corollary from the principle of industrial competition, that this scarcity value will be exactly sufficient to equalize the average rates of profit on different amounts of capital.

Nor, again, can it be known that this advantage of large capitals will be equal in different industries: indeed we have already had occasion to observe that it is not equal, and that in some cases—as e.g. in certain branches of agriculture—the small

producers have important counterbalancing advantages. But so far as the opportunities of large and small capitalists respectively vary from industry to industry, it is obviously impossible to argue *a priori* that average profits *per cent.* of capital tend to an equality in different industries; since on the contrary it is probable that this rate will be higher in such industries as are favourable to production on a small scale. And the same conditions must also preclude the assumption that the normal rate of profit in any industry is independent of the demand for the product of the industry; since any considerable enlargement of this demand is not unlikely to increase the advantages of the larger scale of production in the industry in question.

But there is another and more obvious way in which the increase of production caused by an increase of demand will tend to modify the cost of production: viz. through the increased scope that will be given for applying the principle of division of labour. The extent of the economic gain that may be expected to result from this will, of course, be very different in different cases; nor can we even assert that there will be in every case *some* gain. But we may affirm that, generally speaking, a material increase in the amount of capital and labour which is applied in any process of manufacture is likely to diminish the expense of producing any given amount of the product¹. Hence, so far as this tendency operates, it seems clear that the determination of Natural Value by Cost of Production is theoretically incompetent to give us a single definite result—even assuming “ordinary profit” to be as definite and uniform as Mill supposes. For, if cost of production tends to decrease as the amount supplied increases, while, again, demand extends as price decreases, there may obviously be a number of different amounts which can be produced with the ordinary profit at prices at which the corresponding demand will just take them off.

¹ The opposite tendency of cost of production to increase in consequence of a reduction in the aggregate amount required to be produced is slighter and still more uncertain; since the advantages of a higher organisation of industry are not likely to be given up without a struggle, when they have once been gained; and in many cases the probable result would be to concentrate the manufacture in a few hands, rather than to diminish the average scale of production.

It will be evident from what has been said that products, of which the cost of production remains uniform while the supply is increased indefinitely, cannot form (as Mill supposes) a "large" class. It appears, in fact, that this uniformity can only result from the accidental balancing of two opposite tendencies; the tendency to diminution of cost through division of labour, and the tendency to increase of cost through increased scarcity either of the labourers best qualified for the industry in question or industries subsidiary to it, or of the materials or instruments best adapted for such industries, so far as they are supplied by nature. The former of these tendencies is generally predominant in the case of what are commonly distinguished as "manufactured" articles; the latter in the case of the so-called "raw products" of agriculture¹. The land that is the most important instrument for the production of these latter is not absolutely limited in amount, except in the case of a few comparatively unimportant products; but in an old country, when an additional supply of agricultural produce is required in any place, it has generally to be obtained either (1) from land worse in quality (relatively to the product in question) or less conveniently situated than that from which the market has been previously supplied; or (2) by a less productive application of Capital and Labour to the land already cultivated. In either case, of course, there will be an increase of cost, which will not, generally speaking, be compensated by consistent saving from division of labour. Hence Mill rightly places agricultural produce in his Third Class of commodities, of which the supply may be increased indefinitely, but at an increasing cost of production. Though even here there is a formal incompleteness in his statement of the manner in which the natural value of such products is determined. It is determined, he says, by the cost

¹ It is desirable here to distinguish two different kinds of deviation from uniformity: (1) the cost of production may tend to be uniform for all producers, so long as the total amount produced does not vary materially, but at the same time may tend to vary with any material variation of the latter; or (2) what is produced may be normally produced at different costs, and there may also be further variation as the amount produced varies. The second case is that of agricultural products generally; the first is approximately the case of many manufactured articles, so far at least as all elements of cost except the *entrepreneur's* remuneration are concerned.

of production of the most costly portion supplied: but, obviously, this is only determined when the whole amount is determined: therefore the question still remains, What is the whole amount that it is the producers' interest to produce? This incompleteness, however, is easily removed; since the general answer to the above question is very simple: because, so long as the conditions of industry and the law of demand remain unaltered, there is only one normal price at which the equation of supply and demand will be realised. Competition will obviously lead the producers to extend the supply until the price is brought down to the point at which the most costly portion is only just remuneratively produced. And it is further evident that there can be only one such point: for after one such point has been reached, any further increase of average supply would involve an increased cost of production of the most costly portion of the supply; while the extension of demand necessary to take off the increased supply, would involve a decreased price: so that the producers would lose doubly.

§ 9. To sum up; the Ricardian theory of the determination of Value by Cost of Production appears to me incontrovertible, at least as applied to modern civilised communities, if it is understood in a broad and vague sense; i.e. if it is understood merely to affirm that industrial competition is a force constantly acting in the direction of equalizing the remunerations of producers of the same class in different departments of industry, by increasing the supply—and so lowering the price—of commodities of which the producers are known to be receiving remunerations above the average of their respective classes, and similarly diminishing the supply and raising the price of the products of less profitable industries. But in the more exact and definite form in which the theory is stated even by Mill, it appears to me open to grave objections. It is the least of these objections that the suppositions made are too simple and uniform to correspond closely to the facts; defects of this kind beset all hypotheses framed for deductive reasoning on social phenomena, and all that we can do to remedy them is to note carefully the errors that thus come in and make a rough allowance for them. Of this nature is the error before pointed out in the supposition that industrial competition tends to

establish a definite normal rate of profit in each industry, even when the statement is limited to capitals of about the same amount. As I have said, it is true that industrial competition *tends* to produce this result; but in admitting this we ought to note how much the mutual knowledge of profits actually obtainable by producers falls short of the mutual knowledge of prices actually obtainable by dealers in a tolerably well-organized market of material products; and how in consequence the tendency to a normal rate of profits begins to act feebly and vaguely, at a considerable interval from the attainment of the supposed definite result. In the case of wages this particular source of error is of less importance, since the actual rate of wages in any industry is easier to ascertain than the actual rate of profits; but here on the other hand the proportion between remuneration and sacrifice that industrial competition tends to establish is actually subject to more serious retardation and interference from various causes; especially from the difficulty of attracting labour from district to district and from industry to industry, and the different degrees in which custom and combination together operate in keeping wages up (or down) in different employments. So far, however, as the operation of these causes is independent of the demand for the product of the labour remunerated, they are more important in the theory of distribution than in the general theory of exchange; since they do not necessarily prevent the establishment, at any given time and place, of a normal cost of production towards which the market price tends to return after any variation temporarily caused by changes in demand or accidental excesses or deficiencies in supply. But so far as differences of wages are admittedly due to causes of which the operation is necessarily affected by variations in the demand for different kinds of labour—and we have seen that this is the case according to Mill's own view of industrial grades—it is manifestly illegitimate to regard cost of production as independent of demand; and equally so, wherever increased aggregate production tends to economy in the amount of labour required for a given amount of product. Here then, in my view, lies the gravest theoretical defect in the doctrine of "value depending on cost of production," as stated by Mill and other Ricardians.

It is not merely inconsistent with facts, but with other parts of Mill's economic teaching, to say broadly that "the value of things which can be increased in quantity at pleasure does not depend (except accidentally, and during the time necessary for production to adapt itself) upon demand." Even where the cost of production can be assumed to be approximately the same for all producers, we should generally represent the facts best by supposing that in any given social and industrial conditions this cost of production will vary with the amount produced according to some law, just as we suppose that the amount demanded will vary with the price according to some law; though the former variation will no doubt be generally much slighter than the latter. The proposition, therefore, that the natural price of any product of this kind is equal to its cost of production, is certainly a true statement—on the assumption and with the qualifications already explained—but it is in almost all cases an insufficient one. Our formula must rather be, that it is a price at which the amount demanded is equal to the amount that would permanently be produced at a cost equal to the price, supposing social and industrial conditions unchanged¹.

In the case of products of Mill's third class, of which the cost of production must be taken to be different for different portions of the aggregate amount produced, and to increase steadily as the aggregate increases, the formula becomes somewhat more complicated; the natural price must be stated to be that at which adequate remuneration could just be afforded to the producers of the costliest portion that it would be permanently worth while to produce, if social and industrial conditions remained unaltered.

We are thus enabled to show the close relation, which Mill's phraseology certainly tends to obscure, between the formula for

¹ It is quite possible, as we have seen, that there may be several such prices; in which case it is a problem of some delicacy to determine which of these prices the force of industrial competition will, in any particular instance, be actually tending to realise. This problem—like the one discussed in the next section—cannot, in my opinion, be satisfactorily attempted, even in its simplest and most abstract form, without the aid of geometrical or symbolical methods; and in the present state of our knowledge of the facts of industry, I hardly think that our grasp of these facts is likely to gain much from a solution of this problem.

competitively determining Natural Price, and the corresponding formula for Market Price. Market Price—supposing it definite and single as it would be in a perfect market—was explained to be the price at which the demand for the product in question would be sufficiently extensive to take off the actual supply (allowing for the possible withdrawal of a part of this supply in view of a prospective rise in demand or diminution of supply); while Natural Price (as we have seen) is similarly determined as the price at which the demand would be sufficiently extensive to take off the supply which, assuming social and industrial conditions unchanged, might permanently¹ be expected to be produced at that price. There is, in fact, no sharp line to be drawn between the determinants in the two cases; prospective changes in cost of production, if their effect may be expected to be rapid and considerable, will enter into the calculations of dealers that influence market-prices through supply, as much as any other conditions of prospective supply or demand.

§ 10. So far we have conceived each product as the result of a separate process of production. But, as Mill points out in a subsequent chapter², it frequently happens that two or more products are produced in the course of the same industrial process. “For example, coke and coal gas are both produced from the same material, and by the same operation. In a more partial sense, mutton and wool are an example; beef, hides and tallow,” &c. In such cases the determination of the prices of the articles thus industrially connected, by Cost of Production and Demand conjointly, is necessarily more complicated. All that can be stated generally is that the prices and amounts of any such set of products, under the action of industrial competition, will tend to conform to two conditions. Firstly the prices will tend to be such that the sum of them will repay their joint cost of production, including normal profit³ on the

¹ “Permanently”—because from the risk of starting a new business, especially in industries where production is on a large scale, from the difficulty of removing capital durably invested in forms specially adapted to particular industries, and other similar causes, market prices, however perfect competition became, would often be liable to remain long above or below their corresponding natural prices.

² B. III. c. xvi.

³ By “normal profit” I mean “profit not much above or below the average

capital employed : secondly the amounts will tend to be such that the demand for each article at the price will just about take off the supply. It is quite conceivable that these conditions may be equally satisfied by several different adjustments of prices and amounts; whether this be so or not in any particular case cannot be ascertained without a knowledge of the laws of demand of the particular articles. It should be observed that in the examples above given the products are so connected that their amounts must increase or decrease together : but often they are wholly or to some extent alternatives, so that an increase in the production of one will, in the first instance at least, be attended by a diminution in the production of another. For instance, veal and milk, chickens and eggs, &c., are connected in this latter way. In the former case any rise in the demand for one only of the connected products, since by raising the joint price it will increase the supply of both, must obviously tend to lower the price of the other ; as the sale of this latter will have to be extended without any rise in the demand for it. In the second case, on the other hand, any sudden rise in the demand for either product is likely to raise the price of the other temporarily—and perhaps permanently—by causing restriction of its supply. A more indirect connexion of this second class is that which subsists between commodities of which the production requires the same kind of raw or auxiliary material. In all such cases a rise in the demand for one of the connected commodities will in the first instance tend to increase the cost of production of the other ; but whether this increase will tend to be sustained will depend on whether the production of the material in question becomes more costly, in whole or in part, by being increased in amount.

Finally, it should be noticed that the values of two commodities may be connected through Demand, as well as through Supply ; so far as one of the two is, either in ordinary consumption or in any kind of production, a substitute for the other. Thus (e.g.) an extension in the demand for mutton, due to a fall in its value, would have the effect of restricting the “profit to be obtained on equal amounts of capital in other industries that do not impose more sacrifices or require scarcer qualifications.”

demand for beef, and would tend thereby to affect its cost of production and value. Indeed this kind of connexion may be said to subsist, in an attenuated form, among commodities generally; since such an extension in the demand for any one commodity as makes the aggregate price paid for it a larger share of the income of the community, tends *pro tanto* to reduce the demand for all other articles of consumption. The actual extent to which any one commodity may thus become an alternative for any other is of course extremely different in different cases; and a careful examination of these varying connexions is a fundamentally important element in any investigation of the specific laws of demand of different commodities.

CHAPTER III.

THEORY OF INTERNATIONAL VALUES.

§ 1. IN the preceding chapter the cost of carriage of commodities to the markets in which their price is actually determined, has been cursorily noticed as a normal element in the cost of production. It is almost superfluous to observe that it is an element to which the development of industry has hitherto tended to give continually increasing importance. Though the progress of invention has steadily operated to reduce the average cost of conveying a given weight of goods over a given space; still the amount of goods carried and the distances over which they are conveyed has continually increased in a greater ratio to the reduction of the proportional cost of conveyance; so that, in the most civilised part of the world, the proportion of the labour and capital of mankind at present employed in the business of conveyance is larger than it was at any earlier period in the history of civilisation. This is so strikingly the case that the growth of a nation's foreign trade is sometimes vaguely spoken of as though it constituted absolute and unquestionable evidence of advance in industrial prosperity. It may therefore be useful to point out—what might otherwise seem too obvious to be worth stating—that it is *ceteris paribus* an economic disadvantage that any commodity should be produced at a distance from the market in which it is normally sold; and that if in any case this disadvantage can be got rid of—without incurring any equally serious drawback—through the production at home of some commodity hitherto exported from abroad, the resulting diminution of trade would obviously be a mark of industrial improvement, and not of

retrogression. And *a priori* we have every reason to suppose that, in the continually changing conditions of industry, opportunities for this kind of improvement will continually present themselves; and that the *vis inertiae* of custom is no less liable to maintain the importation from abroad of goods which might be advantageously produced in the proximity of their market, than it is to keep any other part of the process of production in an economically backward condition. And therefore while the progress of industry, under the stimulus of alert and enlightened self-interest, may be doubtless expected to extend and enlarge trade continually in some directions, it is at the same time probable that it will reduce and diminish it in others.

As in the present chapter I propose to consider the special conditions affecting the value of commodities produced at a considerable distance from their consumers, it seems expedient to obtain a clear view of the cases in which such production is likely to be remunerative, and may accordingly be assumed as a normal element of a competitively organized industrial society. The following are the chief cases which it is important to distinguish.

Some commodities for which there is a general demand cannot be produced at all except in certain localities, removed at a considerable distance from other parts of the habitable world. This is the case, generally speaking, with metals and other products of extractive industry; and also with certain agricultural products, such as wines of special quality.

There are other staples of international trade which could generally be produced at a moderate distance from their consumers, at least over a large part of the region inhabited by civilised man; but which can be produced, even in distant markets, at a less expenditure of labour and capital if they are grown or manufactured in certain places which offer special natural advantages for their production. This is the case, to a varying extent, with corn and other important products of agriculture.

III. In other cases, again, commodities can be produced for distant markets with an economy of labour and capital, not on account of any special advantages afforded by the place

in which they are made, but because the cost of carriage is outweighed by the economic gain through co-operation and division of labour, obtained by the concentration of a manufacture—or of several connected manufactures—in one locality. To some extent this gain consists merely in the substitution of a more important saving of carriage for a less important; the cost of conveying raw and auxiliary materials required in the manufacture, or of conveying the product itself from one set of workers to another, being reduced by the local concentration of connected industries to an extent that more than compensates for the additional cost of conveying the finished product to the consumer. But besides this, various other advantages, previously noticed¹, of production on a large scale are obviously only obtainable if a correspondingly large normal demand can be secured for the product; and in the case of commodities of which the amount consumed by any one individual is small, an extensive demand must necessarily be the demand of consumers scattered over a wide area.

IV. The gain thus derivable from co-operation rendering it economically advantageous for men to aggregate themselves in the large closely packed masses which we find in continually increasing size in modern industrial towns; it becomes physically impossible to obtain the supply of food, fuel, and certain other commodities required in large amounts for the ordinary consumption of any such mass otherwise than by bringing a large part of it from a considerable distance. And, through the operation of the Law of Diminishing Returns from Land, of which we have spoken in a previous chapter, the area from which it is economically advantageous to obtain any given amount of such products will always be decidedly less than that from which it is physically possible to do so.

V. Finally, we have to notice the important case in which a commodity is most economically obtained from a distance, because though it could be produced in the neighbourhood of its market with no greater—or even less—expenditure of labour and capital, still its cost of production as estimated in wages and profits would be so much greater as to more than counterbalance the saving in cost of carriage. A striking

¹ Cf. Book I. c. iv. § 6.

instance of this was furnished by the gold discoveries of Australia; one consequence of which was that Australia began to import cheese and butter largely from abroad, although the pastures of New South Wales and Victoria offer unusual facilities for dairy-farming. The high average remuneration obtainable by labour in gold-mining had raised the wages of Australian labour generally—and therefore in dairy-farming—so much, that the consequent additional expense of making butter in Australia was greater than the expense of conveying it from Ireland¹.

§ 2. It is evident that this last cause of foreign trade can only operate, so far as physical or social obstacles render the mobility of labour temporarily or permanently imperfect. Had it been as easy to draw over Irish labourers to Australia as it is to bring them to England, their influx would soon have brought down wages to a point at which it would have been less expensive to produce the butter required by Australia in Australian dairies. Now, according to Mill and his most influential disciples, it is only on account of this imperfect mobility that a special formula is required for determining the values of commodities brought from distant places; it is owing to the differences which this imperfect mobility allows to subsist between the remuneration of labourers or capitalists or both in different countries, that cost of production is prevented from determining the normal value of such imported commodities. To take Mill's illustration: suppose England imports wine from Spain, giving cloth in exchange: then "if the cloth and the wine were both made in Spain, they would exchange at their cost of production in Spain; if they were made in England, they would exchange at the cost of production in England. But"—we are told—"all the cloth being made in England and all the wine in Spain, they are in circumstances to which the law of cost of production is not applicable. We must accordingly fall back upon an antecedent law, that of Supply and Demand;" and take, as the formula for determining the values of the commodities in question, what "may be appropriately named the Equation of International Demand;" the law, namely, that "the produce of a country exchanges for the produce of other countries at such

¹ Cf. Cairnes, *Essays in Political Economy*, i. p. 88.

“values as are required in order that the whole of her exports “may exactly pay for the whole of her imports”¹.”

I agree with Mill in regarding this as the true formula for determining the values of commodities exchanged between distant countries; but he does not appear to me to have given the right reasons for adopting it, nor to have taken note of its theoretical limits. His error is most conspicuously manifested in the earlier part of his argument, in which, to exhibit most simply the “elementary principle of International Values,” he omits the consideration of the cost of carriage; and supposes, for the sake of argument, that the carriage of commodities from one country to the other could be effected without labour and without cost. It is easy to show that, under the circumstances thus supposed, cost of production must determine the value of exported commodities just as much as the value of commodities consumed where they are made; except we make the further hypothesis, rarely likely to be realised in fact, that, after the trade is established, there is no product *common* to the trading countries. For let us take Mill’s case of England exchanging cloth for the wine of Spain; and let us suppose that there is at least one other commodity—say corn—which is produced both in England and in Spain. According to Mill’s general theory of value, discussed in the preceding chapter, the relative values of cloth and corn in England must be determined by their comparative costs of production; and, again, the relative values of wine and corn in Spain must be determined in the same way. But if we suppose cost of carriage to be eliminated, there is no reason why the value either of wine or cloth should be altered by exportation; hence, the values of both wine and cloth relatively to corn, and therefore relatively to each other, must be completely determined by the principle of cost of production; although the wine and cloth may not exchange for each other in proportion to their respective costs. The “Equation of International Demand” will still be maintained, but it will have no effect in determining the value of wine or of cloth; since, if we leave cost of carriage out of account, there can be no reason why the wine should be entirely paid for in cloth, or *vice versa*; there can be no reason why any debt remaining on either side, after

¹ Mill, *Pol. Econ.* B. III. c. xviii. § 1.

balancing the wine against the cloth, should not be liquidated in corn or some other commodity.

It is clear, then, that cost of carriage cannot be left out of account in any exposition of the need of a special principle for determining International Values. And in fact it appears to me that this need depends fundamentally on a condition to which Mill has not adverted: viz. that in explaining the determination of international values we have to take into account not merely the expense of conveying wares into the foreign country, but also the expense of bringing home their value in some form or other. And if in "Cost of Production including carriage" we include this *double* carriage—carriage of goods, say, from England to Spain, and also carriage of what is paid for them back from Spain to England—then it is inexact to speak of cost of production as having no relation to the determination of the price of English goods in Spain; but it enters in merely as giving the limit, the maximum which the competitive price can reach, not the exact point which it actually does tend to reach in ordinary cases.

This will become clearer if we consider an exceptional case in which cost of production, thus understood, would determine the value of the products of foreign trade, on the assumption of free competition, as definitely as it can determine the value of commodities produced at home.

Suppose there are two countries A and B, precisely similar in their conditions of production as regards all commodities except silk, which is produced in A by labour and capital which A has in excess of B, and which is incapable of being produced in B, though it would be eagerly consumed there; and suppose that a trade previously prevented is now opened for the first time between A and B. Silk will undoubtedly be carried from A to B, but as the trader could take back nothing which would have a higher value in B than it had in A, he must to recoup himself sell the silk permanently at a value which will pay not only the whole expense (including normal profit¹) of carrying it from A to B, but also the whole expense

¹ For the purpose of the highly abstract and hypothetical reasoning required in this chapter, it is necessary to suppose 'normal profit' to be more definitely and simply determined than we have seen to be actually the case.

of carrying back something else—whatever can be most conveniently carried—from B to A. He must charge this, in order to get the ordinary profit; and competition would prevent him from charging more. In this case the normal value of silk in B will evidently exceed its value in A by exactly the double cost of carriage between the two countries; and will therefore be determined by the cost of production in the special sense above defined.

The case supposed is no doubt highly improbable;—and even if it existed at the outset, it would most likely be modified in consequence of the trade itself. It is almost certain that there would be some commodity in the production of which the second country B had a certain advantage—which if produced in A had to be produced at a higher relative cost of production. Let us suppose that there is one such commodity; which we will take to be hardware. Then, even though the advantage were comparatively slight, and less than would be required to pay the cost of carrying the hardware from B to A, it is evident that the trader who exported the silk to B would gain something extra by bringing back the proceeds of its sale to A in hardware rather than any other article. And this extra gain—like any other diminution in the expenses of bringing an article to market—industrial competition will tend to transfer to the consumers. But the question still remains, To which set of consumers will it be transferred? to those of A or to those of B? If the amount imported from B is not sufficient to supply the whole demand for hardware in A, at the price at which it can be remuneratively produced in that country, the normal price of hardware in A may be kept up by its home cost of production; so that the consumers of silk in A will reap the whole extra gain. But if we suppose that, when the trade is fully established, neither of the wares exchanged is produced in the importing country; the principle that ‘price must correspond to cost of production’ does not determine in which of two different ways the traders’ profits will tend to be brought down to the ordinary level whether by selling A’s wares a little cheaper in B or B’s wares a little cheaper in A. The combination of these two results that the competition of traders will tend to bring about will be determined, *ceteris*

paribus, as I shall presently explain, by the relation of the demand for A's wares in B to the demand for B's wares in A. But at any rate it must be a combination that will make the quantity of A's wares sold in B equal in value to the quantity of B's wares sold in A¹. And since the tendency to this result will operate equally, however many wares are exchanged on either side, we thus arrive at Mill's "Equation of International Demand" as the formula for determining normal international values. When this equation is realised, the trade may be said to be in equilibrium; and under the action of industrial competition it must always be conceived as tending towards equilibrium; though actually, as the laws of demand no less than the conditions of supply are continually varying, the point of equilibrium must be conceived to undergo corresponding variations; and, at any given time, the tendencies towards equilibrium may easily be less strong than tendencies in the opposite direction, due to unforeseen changes in trade or industry².

We may now observe that in the above reasoning it has not been explicitly assumed, that labour and capital do not move freely between the trading countries; and we have only made this assumption implicitly so far as we have ignored effects on labourers and capitalists, regarded as purchasers, of any changes in the value of the wares exchanged in the trade. And it is only to this extent that, in my opinion, the assumption of the imperfect mobility of capital is required to give scope for the operation of the law of international values above stated. It is doubtless true that if we suppose a mobility of labour and capital within a nation so perfect and delicate that every change in the price of articles brought from a distance to any

¹ I assume for the present that there are no payments to be made between the two countries on account of other transactions than those of trade.

² Mill is right in pointing out that there may possibly be several points of equilibrium: the laws of demand for the commodities exchanged may be such that the equation of reciprocal demand may be equally well established at any one of a number of different pairs of prices. But he does not seem to be aware that this kind of indeterminateness is not peculiar to the theory of International Value: in the course of the previous chapter we have had occasion to notice more than one case in which it occurs in dealing with the values of products sold in the country in which they are produced.

locality must be conceived to have a certain effect in attracting or repelling inhabitants from that locality; then certainly the equation of reciprocal demand will have no place in determining the rate of interchange between two places within such a nation, since its effect would be overborne by the tendency to equalize the aggregate of utilities obtainable by similar sacrifices in different localities. But if we merely assume the mobility of capital to be so far imperfect, that capitalists will not transport themselves from A to B, in order to get B's exports cheaper at the cost of getting A's exports dearer; then, so far as trade between distant places exists, the Equation of International Demand must be the formula for theoretically determining the values of the products of such trade.

§ 3. It thus appears that, as was before said, the most important part of the reason why the theory of determination by cost of production, even in the modified form in which I have stated it, cannot be applied without qualification to the products of international trade, is that a double cost of carriage has here to be taken into account; and, that owing to the comparative advantage that each trading country usually has over the other in some article, each can normally obtain the wares of the other at a price *lower* than what corresponds to expenses of production *plus* double carriage. In fact, we have here a special case of the kind discussed at the close of the preceding chapter, in which the values of two commodities are causally connected through their being the joint products of one process of production; the one process here being the process of double carriage, each half of which is commercially inseparable from the other.

No doubt the imperfect mobility of capital has the important effects that Ricardo and Mill attribute to it, on the course of international trade; since it is thereby rendered profitable for a country to buy wares from abroad which it could produce with less labour and delay at home; because it can employ its labour and capital still more advantageously in some other way. Still, though the imperfect mobility of capital largely determines *what* wares are exchanged between the two countries, the question which a special theory of international values has to answer relates to the division of the

double cost of carriage which trade involves between the two sets of commodities. What the equation of reciprocal demand between two countries A and B will determine,—supposing for simplicity's sake that they are restricted to trading with each other,—is how much of the double cost of carriage between A and B will be added to the price of A's products in B, and how much to the price of B's products in A. It may happen, of course, that each product is sold at such a price that it exactly pays its own cost of carriage; but there is no general tendency to this result. The price of A's imports from B may rise beyond this up to the point at which they pay the whole cost of carriage of B's imports from A; and similarly they may fall below this down to the point at which they pay no share at all of the double cost of carriage. Thus the home cost of production together with double cost of carriage gives us a *maximum* value, and home cost of production without cost of carriage a *minimum* value; between which the normal value of wares in a foreign country may vary indefinitely with the varying conditions of trade; but no wares (except such as are scarce naturally or through monopoly) can rise, unless very temporarily, above the former point, and only under very exceptional circumstances can any fall below the latter. In the limiting case which I first discussed, of two countries exactly alike in all their conditions of production, except that one product consumed in both was produced only in one, the price of this product would, as was shown, reach the maximum just mentioned in the country which did not produce it: while the price of whatever equivalents were taken in exchange for it, obviously could not rise above the minimum; since by hypothesis the conditions of production of all other wares are exactly alike in the two countries, and therefore their exchange-values (measured by any other standard except the single exceptional product) must be the same. In actual trade it never happens that either extreme is reached, at least by the aggregate of a country's exports; there are always some products to be found in producing which a country has at least a relative advantage as compared with some of the countries with which it trades; accordingly most (if not all) of the wares of international trade are normally sold in the countries importing

them at prices which will pay at least some part of their cost of carriage, as well as their home cost of production.

The determination of the exact share of the cost that would normally be added to the price of each commodity would be a very complicated problem, even if treated in the most abstract form, and even supposing that we knew the precise law according to which the demand for each commodity would extend or contract as its price fell or rose. In default of any such knowledge we can only say generally, that in proportion as the demand in either country for the foreign wares of the other is more *extensible* or *elastic* than the corresponding demand on the other side—i.e. in proportion as the law of demand for the foreign wares is of such a kind that a comparatively small fall in their prices causes, *ceteris paribus*, a comparatively large extension in the demand for them—the larger will be the share of the double cost of carriage that will tend to be added to the imports of the country in question. For, under these conditions of demand, a comparatively small fall in price (per unit) is required for a large increment in the total amount of the wares sold; and therefore through the oscillations of supply that practically determine, at any given time, the division of the double cost of carriage, this elasticity of demand will keep up the prices on the one side as compared with the other; so that the equilibrium of trade will tend to be attained at a rate of interchange favourable to the country where the demand for foreign wares is less elastic.

So far we have not taken into account the effect of changes in demand on the cost of production of the wares exchanged. It is important to bear in mind that the expense of producing such wares—estimated separately from the expense of the trade itself—will often be materially altered by the extension of their sale which the trade brings about; and their prices as imports will of course be altered in the same direction (though not necessarily in precisely the same ratio). On the one hand, in the case of manufactured articles, the extension of sale is sometimes the cause of a material cheapening in their cost of production, by enabling the manufacture to be carried on upon a larger scale; while, on the other hand, in the case of agricultural produce, we can often observe that the initial rise of

price which the foreign demand causes is sustained by a permanent increase in the cost of producing the costliest portion of the article. Still, if we suppose the trade to be fully established, so long as its extension, and the general conditions of demand and supply, remain unaltered, the reaction of casual oscillations of demand on the respective costs of production of the wares exchanged can hardly be important enough to affect materially the normal equilibrium of the trade; and therefore we need not take them into account in the special theory of international values.

§ 4. I may here observe that, even in this abstract treatment of the theory, we ought not to ignore the inevitable inexactness of the measurements that we are seeking to determine. This seems the most convenient place to explain a proviso, which I should have placed at the outset of this chapter, only that the explanation of it is more easily understood at the point of the discussion which we have now reached. We cannot, in the theory of international trade, use the notion of 'price' exactly as it was used in discussing the values of wares sold in the country in which they are produced. In the latter case we are only required to assume, as was stated in the preceding chapter, that the value of money remains unchanged. But we cannot similarly suppose, in treating of international trade, that the value of gold or silver bullion—the metallic money of commerce—remains unchanged as we pass from one country to another; since bullion is itself an article of trade, and therefore, like any other article of trade, it will normally have a value in the country which obtains it by trade higher than that which it has where it is produced, by some portion of the cost of its own carriage and of that of the equivalent brought home in exchange for it. Hence in considering the phenomena of International Trade we must always conceive money as something that varies in value from country to country; and therefore we must conceive price as estimated not in the actual money of either country, but by a standard of value common to the countries, obtained by estimating and allowing for the differences in the value of actual money. For convenience sake we will distinguish the price so estimated as 'real price.' The manner in which this common standard of

value is to be obtained, has been explained in an earlier chapter¹; in which also the degree of inexactness to which it is liable has been carefully noted. It must therefore be borne in mind that the reasonings in the present chapter are to be taken as subject to a similar inexactness.

It is especially important to bear in mind this meaning of 'price' when we examine the facts of the Foreign Exchanges by the light of the abstract theory of International Values; otherwise we may be led to trace in these facts a more simple and patent manifestation of the law above expounded than they really exhibit. For it is plainly by means of the fluctuations of the exchanges that the transactions of Importation and Exportation are economically connected. At first sight each process appears quite separate from the other; the importers and exporters respectively have to bear their own costs and take care of their own profits; hence a hasty reasoner might conclude that competition would tend to make the value of imports in either country correspond to the cost of production, including the cost of conveying the imports to market, and of course ordinary trade profits. But this inference would manifestly leave out of account the fluctuations of the exchanges. It is true that when exchange is at par between England and the United States the (money) price of English wares in the United States tends to correspond to their cost of production in England, estimated in money, together with the cost of carriage of the wares. But the exchange may vary on either side to 'specie point': for instance, the premium in England on bills on the United States may reach the point at which it would be as cheap to send money. At this point, then, the cost of supplying American wares in England must substantially include the cost of conveying money back to America. On the other hand, when the opposite extreme of the fluctuation is reached, the cost of carriage of the wares themselves is at least partly paid by premiums on bills².

These fluctuations accordingly exemplify and in a sense *represent* the fluctuations in the rate of interchange of which

¹ Book I. c. ii.

² I say 'at least partly,' because in most cases the expense of conveying goods is greater than the expense of conveying money.

our theory gave an account. But, for the reason explained in the preceding paragraph, they do not exactly correspond to them. For if money have a greater purchasing power in the United States than in England, the addition to the real price of English goods in the United States, over their real price in England, will be correspondingly greater than it appears; and *vice versâ*. Hence, in order that the real limit of fluctuation in the rate of interchange between the two countries may be actually reached, it may be necessary that money should pass from one country to another so as to alter its value in the former¹.

In the preceding discussion I have supposed for simplicity's sake that only two countries are engaged in trade, and that their mutual indebtedness arises only from the exchange of their respective produce. In applying the theory to concrete facts it must be borne in mind, first, that the mutual indebtedness of nations results "from the relative totals of all the amounts expended by each upon the other, whether in payment of produce and manufactures, or for the purchase of shares and public securities, or for the settlement of profits, commissions, or tributes of any kind, or for the discharge of the expenses incurred in foreign residence or travel: in fact, from the entire payments (or promises to pay) which pass between the respective countries. The liability incurred is identical in its effect, whatever its origin may be²;" every such liability has to be liquidated by the transmission either

¹ It may be thought perhaps that, in case money is at a different value in the two countries, the fluctuation of the exchanges might carry the real fluctuations of the rate of interchange between the countries beyond the points indicated by the theory before explained. For if bullion has a higher value in England than in the United States, then when the premium on American bills is about equal to the cost of sending bullion, American products in England, if their sale is to be profitable, must have their *real* price increased by *more* than the double cost of carriage. And it is no doubt true that the increment of real price under these circumstances might conceivably exceed the cost of carriage of the American exports + the cost of carriage of the *bullion* required to pay for them. But it could not *permanently* exceed the cost of carriage of the American exports + the cost of carriage of the most conveniently transported English goods; for if it did exceed this it would become profitable to export these goods to America, and they would be exported.

² Goschen, *Foreign Exchanges*, c. 2.

of money or of an order to receive money payable in the foreign country. Still the greatest part of the transactions by which debts are incurred between countries, and the means of paying such debts obtained, are the importations and exportations of produce.

And secondly, it must be borne in mind that the condition of the Foreign Exchanges of any country, and consequently the share that it pays of the cost of its foreign trade, depends on its relations of debit and credit not with each country separately, but with all countries taken together; since, through the process technically called arbitration of exchange, a payment due from country A to country B may be made by assigning to B a debt due from a third country C to A. "There is some little additional expense, partly commission "and partly loss of interest, in settling debts in this circuitous "manner, and to the extent of that small difference the exchange with one country may vary apart from that with "others; but in the main, the exchanges with all foreign "countries vary together, according as the country has a "balance to receive or to pay on the general result of its "foreign transactions¹."

§ 5. Finally, a plausible objection may be brought not against the substance of the theory as above expounded, but against the title which I have retained. It may be said that it should be called a 'Theory of the values of wares exchanged between 'distant places,' instead of a Theory of International Values. The reasons why I have kept the term International are partly theoretical, partly practical. Theoretically, I do not wish to discard altogether the economic conception of a nation adopted (implicitly) by Ricardo and Mill; i. e. a community inhabiting a region within which labour and capital are perfectly mobile. And, as we have seen, the assumption of absolutely perfect mobility of capital and labour, supersedes the necessity of considering the equation of reciprocal demand. So far as we do not assume this degree of mobility, the theory above expounded applies no doubt to trade within a country, as well as to foreign trade; only it applies in a less degree, in proportion as the distances are smaller and the expense of transmitting

¹ Mill, Book III, c. XX, § 3.

money less. It is true that in a country where the same paper currency was used throughout, the facts that we have been examining would generally escape notice; because as the cost of transmitting money would be trifling, there could be no manifest fluctuations of inland exchange. Still, none the less would money be more abundant and prices at a higher level in towns or districts for whose products there was a keen demand in other parts of the country: so that the former would really bear less than an equal share of the cost of the trade that they carried on with the latter. Accordingly, there is no broad line to be drawn—apart from the effects of governmental interference—between the laws actually governing the values of products sold within the country in which they are produced, and the laws governing the values of imported wares. All that can be said is that in dealing with a modern civilised country, duly furnished with means of communication and conveyance and substitutes for coin, the error involved in our assumption that the market values of domestic products tend to be everywhere the same, allowing for the cost of their carriage to market, will generally speaking be comparatively slight; whereas in considering the values of the wares of international trade, a similar error would not unfrequently be material¹.

At the same time, it is only in the case of Foreign Trade that the investigation of the conditions of favourable interchange excite practical interest; because it is only in this case that there has ever been a serious question of governmental interference with a view of making the interchange more favourable. Whether such interference can ever be on the whole expedient I do not now propose to discuss: but it may be observed that the theoretical determination of the division of the expenses of Foreign Trade does not enable us to determine the total amount of the gain resulting from such trade to either nation. To know this, we must know what each nation would have produced with the labour and capital

¹ Hence, in the discussion of the preceding chapter, we neglected, for simplicity's sake, the differences in the purchasing power of money in different localities within the same country. These differences, as we have before seen, it is theoretically impossible to estimate with perfect exactness; but it should be observed that so far as they actually exist, a further theoretical imperfection is introduced into the determination of value by cost of production.

now employed in producing for foreign trade: which generally we can but vaguely guess.

Nor, again, does it in any way follow that the nation that pays the greatest share of the double cost of carriage is the one that gains least. Indeed the very opposite may very likely be the fact; as will appear if we look again at the hypothetical case considered in § 1, where we supposed an entirely unreciprocated demand in one country B for the products of another country A. Under these circumstances, as we saw, the trade tends to be carried on under the most unfavourable conditions possible for B, as far as the division of expenses is concerned; since the consumers in B have to pay the whole of the double cost of carriage. On the other hand it is not improbable that the consumers in B will have the greater gain in utility; since they obtain access by the trade to an entirely new commodity, whereas the inhabitants of A only obtain at best a somewhat more economical way of acquiring commodities producible at home.

CHAPTER IV.

DEFINITION OF MONEY.

§ 1. IN the course of the preceding chapter we have been led to see the importance, in the theory of "international" values, of a clear view of the nature and causes of variations in the value of money. But the very denotation of the term money is so fluctuating and uncertain, that before we discuss the laws by which its value is determined, it seems desirable to make a thorough and systematic attempt to define the term itself¹.

¹ Mr Jevons, in his excellent little book on "Money," tells us that the ingenious attempts that have been made to define money "involve the logical blunder of supposing that we may, by settling the meaning of a single word, avoid all the complex differences and various conditions of many things, requiring each its own definition." Without denying that this blunder has been sometimes committed, I think it misleading to suggest, as Mr Jevons does, that the attempt to define a class-name necessarily implies a neglect of the specific differences of the things contained in the class. Indeed, when he goes on to say that the many things which are or may be called money—"bullion, standard coin, token coin, convertible and inconvertible notes, legal tender and not legal tender, cheques of various kinds, mercantile bills, exchequer bills, stock certificates, &c."—"require each its own definition," he apparently maintains the rather paradoxical position that it is logically correct to give definitions of a number of species, but logically erroneous to try to define their common genus. It is easy to show that several at least of these more special notions present just the same sort of difficulties when we attempt to determine them precisely as the wider notion "money" does. For instance, the distinction between bullion and coin seems at first sight plain enough; but when we ask under which head we are to classify gold pieces circulating at their market value in a country that has a single silver standard, we see that it is not after all so easy to define coin. The characteristic of being materially coined—that is, cut and stamped by

Here, as in previous attempts to obtain definition, it seems best to begin by a careful and unbiassed consideration of the actual usage of the term. And here we are met at the outset by a rather remarkable phenomenon. There seems to be a tolerable accord among persons who write about money in England at the present time, as to the denotation that ought to be given to the term when they directly attempt to define it; at any rate, the margin of difference is inconsiderable in comparison with the amount of their agreement. Unfortunately the denotation so given is in palpable discrepancy with their customary use of the term when they are not trying to define it; and this discrepancy is not of a minor kind, but as fundamental as can well be conceived. When the question is expressly raised they have no doubt that by money they mean what they also call currency, that is, coin and bank-notes. They see the need of distinguishing the latter as paper money or paper currency; and they recognise the

authority—though it has always been combined in our own experience with the characteristic of being legal tender, is capable of being separated from it; so that we have to choose between the two in our definition. Similarly, we may inquire whether by calling notes convertible it is merely meant that their issuer has promised to convert them into coin on demand, or whether a belief is affirmed that he would so convert them if required? If the latter alternative be chosen, it must be evident that the legitimacy of such a belief must depend upon the nature and extent of the provisions made by the issuer for meeting demands of coin; so that in order to define convertibility precisely we shall have to determine what provisions are adequate, and whether all possible demands should be provided for or only such as may reasonably be expected. Then further, how shall we treat the case—which used to be common in the United States—of notes for which coin will almost certainly be paid if demanded, but not without a serious loss of good-will to the demander? In short, we cannot escape the proverbial difficulties of drawing a line, if we attempt to use any economic terms with precision; and instead of seeing in these difficulties—as Mr Jevons seems to do—a ground for not making the attempt, I venture to take an exactly opposite view of them. I think that there is no method so convenient for bringing before the mind the “complex differences and various conditions” of the matters that it is occupied in studying, as just this effort to define general terms. The gain derived from this process (as I have urged in a previous chapter) is quite independent of its success. We may find that the reasons for drawing any proposed line between money and things rather like money are balanced and indecisive. But since such reasons must consist in statements of the important resemblances and differences of the things that we are trying to classify, the knowledge of them must be useful in economic reasoning, whatever definition we may ultimately adopt.

existence of a narrower definition which restricts the term money to coined metal, on the view that bank-notes are mere promises to pay money, which ought not to be confounded with money, however currently they may be taken for it. But they are generally disposed to reject this view as a heresy; and though the narrower sense is that adopted by several economists of repute, I imagine that it would be regarded as at least old-fashioned by practical men; except so far as the word is quite technically employed in relation to the details of banking business. Again, though in the 'Resumption' controversy in the United States it was maintained that inconvertible notes ought not to be regarded as money, I do not think a definition excluding such notes—but including convertible notes—has ever found favour in England; although English financial authorities are of course agreed that inconvertible paper is a bad kind of money. Further, our authorities allow that there is a certain resemblance between bank-notes and bills of exchange, letters of credit, promissory notes issued by private persons, &c.; but though they may regard these latter as constituting an "auxiliary currency," they do not consider them to be currency in the strictest sense, and therefore do not call them money. The only important point on which their utterances are doubtful or conflicting is the question whether notes issued by private banks and not made legal tender should be considered as money; the importance of this question, however, so far as England is concerned, is continually diminishing. But when bankers and merchants, or those who write for them, are talking of "money" in the sense in which, generally speaking, they are most practically concerned with it—of money which (or, more strictly, the temporary use of which) is continually valued and bought and sold in the money market, which is sometimes "scarce" and "dear" and at other times "cheap" and "plentiful"—they speak of something which must be defined quite differently. For though coin and bank-notes form a specially important part of money-market money, still, in such a country as England where deposit-banking is fully developed and payment by cheques customary, the greater part of such money must consist of what has been called "money of account": that is, of bankers' liabilities or obligations to

pay coin¹ on demand, not “embodied” or represented otherwise than by rows of figures in their books.

What has just been said will appear to some of my readers a truism. But there are probably others to whom it will appear a paradox; and for the sake of these latter it will be well to pause and illustrate pretty fully this use of the term Money. For this purpose I shall take Bagehot’s *Lombard Street* as my authority; as it has the advantage of being written on the one hand for practical men, and on the other hand by a master of abstract economic theory, thoroughly acquainted with the criticisms that theorists have passed on the common language and ways of thinking of dealers in money.

Now it is true that Bagehot never says that in speaking of the money of Lombard Street, the possession of which makes England “the greatest moneyed country in the world,” he means a commodity of which the greater part exists only in the form of bankers’ obligations to pay money on demand; such obligations being not even embodied in bank-notes. But there are many passages in which it is clear that he can mean nothing else². Take, for example, the following:—

“Every one is aware that England...has much more immediately disposable and ready cash than any other country. But very few persons are aware how much greater the ready balance—the floating loan-fund, which can be lent to any one for any purpose—is in England than it is anywhere else in the world. A very few figures will show how large the London loan-fund is, and how much greater it is than any other. The known deposits—the deposits of banks which publish their accounts—are, in

“London (31st December, 1872) . . .	£120,000,000
“Paris (27th February, 1873) . . .	13,000,000
“New York (February, 1873) . . .	40,000,000
“German Empire (31st January, 1873) . . .	8,000,000

¹ It may be said that English bankers are not strictly liable to pay their debts in coin, as they may tender Bank of England notes instead. But as these notes are only legal tender so long as the Issue Department of the Bank of England gives coin for them on demand, the phrase in the text is substantially accurate.

² There are, no doubt, other passages in *Lombard Street*—as will be presently noticed—where ‘money’ is used in the narrower sense of ‘metallic money’.

“And the unknown deposits—the deposits in banks which do not publish their accounts—are in London much greater than those in any other of these cities. The bankers’ deposits of London are many times greater than those of any other city—those of Great Britain many times greater than those of any other country¹.”

Here Bagehot clearly regards these bankers’ deposits as “immediately disposable and ready cash.” But if we ask ourselves where and in what form this “cash” exists, it must be evident that, at any given time, most of it exists only in the form of liabilities or obligations, acknowledged by rows of figures in the bankers’ books; and that it is transferred from owner to owner, and thus fulfils all the functions of a medium of exchange, without ever assuming a more material shape. Most persons, no doubt, who have not specially considered the matter, have a vague impression that these figures in bankers’ books “represent” sovereigns or bank-notes; which, though they are not actually in the banker’s possession, have yet passed through his hands, and exist somewhere in the commercial world. But if this view does not vanish on a few moments’ reflection, it must at any rate be effectually dispelled by a perusal of *Lombard Street*; since the main drift of that book is to bring prominently forward the fact that, in consequence of the “one-reserve system” upon which English banking is constructed, but little of this immense “loan-fund which can be lent to any one” could possibly be presented in the shape of coin or bank-notes. Of course some portion of the money lent by London bankers is continually taken from them in this shape. But a little reflection on the mode in which it is borrowed and used will show how comparatively small this portion is. Such loans are chiefly made to traders, either directly by the bankers or through the agency of the bill-brokers; and when a trader borrows from his bank, he almost always does so by having the loan placed to his credit in his banker’s books, and drawing against it by cheques; and the effect of such cheques, for the most part, is not to cause the money to be produced in the form of coin or notes, but merely to transfer the claim on the banker to some other customer of the same or some other bank. The bank-

¹ *Lombard Street*, c. 1. p. 4.

notes and gold are merely the small change of such loans; and it is only when money is lent to manufacturers and farmers, who have large sums to pay in wages, that the amount of this change bears even a considerable proportion to the whole loan. It may seem that when cheques on one bank are paid into another, material money must pass between bank and bank. But by the system of the Clearing House the mutual claims of the different banks are set off against each other; so that, even when the balance daily due from each bank to others was paid in notes, the amount of these required was very small in proportion to the amount of liabilities transferred; and now no notes are commonly needed at all, as such balances are paid by drafts on the Bank of England, where the other banks keep the main part of their reserves.

But we may reach the same result more briefly by means of a few statistics, which I take from Mr Palgrave's *Notes on Banking*, published in 1873; as I am not aware that any equally complete study of our actual medium of exchange has appeared since that date. Mr Palgrave estimates the whole amount of deposits held by English, Scotch, and Irish banks (exclusive of the discount-houses) on the 12th of March, 1873, at about 486 millions, the liabilities of the London banks alone being about 179 millions: while he estimates the metallic circulation of the whole kingdom in 1872 at about 105 millions, and the note circulation at 43 millions. If we consider that more than 10 millions of notes and coin, on the average, were kept as reserve by the Bank of England, and that the provincial banks require a considerably larger proportion of coin for their daily business than the London banks, we shall require no elaborate proof to convince us that the greater part of the "unequalled loan-fund" of Lombard Street can never emerge from the immaterial condition of bankers' liabilities.

The difficulty, indeed, is not to prove this, but rather to explain why this obvious truth is overlooked, or even implicitly denied; not merely, as has already been said, in all formal definitions of money, but in most of what is said and written about the functions of bankers. Mill, for instance, implies over and over again that the medium of exchange, which it is the business of bankers to collect from private individuals and

lend to traders, consists altogether of coined metal—or at least of coin and paper substitutes for coin made legal tender by Government¹. A similar implication is contained in much of Bagehot's language². And indeed I hardly know a single English writer on the subject, with the exception of Mr Macleod, who does not continually present this view to his readers³.

§ 2. The explanation of this serious and wide-spread inaccuracy of thought and language is, I think, two-fold. In many cases it is due to an inadvertent inference from a part to the whole, of the kind that has caused so many economic fallacies. A practical man is aware that (in ordinary times) he can convert any portion of his banker's liabilities into gold or notes at will, and that he only leaves it in its immaterial condition for his own convenience—being less afraid of the failure of his bank than he is of having his gold or notes stolen. Hence he naturally comes to think and speak of all the "money at his bank" as "ready cash"; and thus, with Bagehot, conceives England as having "more ready cash" than any other country. When, however, he comes to consider possible crises and collapses of credit, the difference between bankers' liabilities and their means of meeting them becomes only too palpable; the same thing that he has just called "cash" appears to him in its opposite character of "credit"; and—again with Bagehot—he views England's "cash in hand" as being "so exceedingly small that a bystander almost trembles at its minuteness compared with the immensity of the "credit that rests upon it." These two views of "cash" or "money" exist side by side in his mind, without being brought into any clear or consistent relation to each other; and thus we get the paradoxical result which I noticed at starting, that when such a practical man is called upon to give an express definition of money, he formally ignores the greater part of the actual medium of exchange, of which in the ordinary course

¹ Compare, among other passages, B. III. c. xi. § 2, and c. xii. § 2.

² Cf. (e. g.) *Lombard Street*, c. vi. p. 143.

³ I take this occasion to acknowledge my obligations to Mr Macleod's *Theory of Banking*, which contains, so far as I know, the first clear and full exposition of the nature and functions of bankers' deposits. In saying this, I must guard myself against being understood to approve of Mr Macleod's general treatment of Economics.

of his business he is continually thinking and speaking as "money."

So far, however, as this inadequate representation of the facts is common also to theoretical economists, it is rather because the existence of this immaterial money is obscured to their view, not by the material money into which the banker is bound to convert it, but by the goods other than money which the bankers' customers purchase by means of it.

For instance, Mill begins his chapter on the Value of Money by "clearing from our path a formidable ambiguity of language," by which, as he explains, money is commonly confounded with capital.

"When one person lends to another," he says, "what he really lends is so much capital; the money is the mere instrument of the transfer. But the capital usually passes from the lender to the receiver through the means either of money, or of an order to receive money, and at any rate it is in money that the capital is computed and estimated. Hence, borrowing capital is universally called borrowing money; the loan market is called the money market . . . and the equivalent given for the use of capital, or, in other words, interest, is not only called the interest of money, but, by a grosser perversion of terms, the value of money."

Now, I do not deny that there is a confusing ambiguity in the phrase, "value of money"; but the language that Mill uses in exposing it seems to me open to a similar objection. It is true that when the value of money is mentioned in Lombard Street, it is not the purchasing power of money, measured in commodities, that is intended; but neither is it exactly the rate of interest, as Mill elsewhere uses this phrase, i.e. the average annual return to capital, subtracting insurance for risk and wages of management. It is, as was before said, the value of the temporary use, not of capital generally, but of money (including bankers' obligations) in particular¹; estimated, as other values are commonly estimated, in terms of money. Of course, a man only borrows money in order to buy something else, or

¹ The causes which tend to make the rate of interest or discount paid for the use of money diverge somewhat from the rate of interest on capital generally will be discussed in the next chapter.

to pay for something already bought; but what he actually borrows is the medium of exchange, and it is materially inexact to represent him as borrowing anything else. The bad effects of this inexactness are, indeed, latent so long as we are dealing with metallic money; for when commodities are bought and sold for hard coin, it is impossible to ignore the fact that they are transferred by means of an instrument which is equal in value to the wealth that it is used to transfer. But when bankers' credit is the medium of exchange, it is easier to let this fact drop out of sight; and Mill continually does so. Thus he speaks contemptuously of an "extension of credit being "talked of . . . as if credit actually were capital," whereas it is only "permission to use the capital of another person." Now, in a certain rather strained way, we might say this of gold coin; its function is to "permit" or enable its owner to obtain and use other wealth. And it is only in this sense that Mill's statement is true of the credit or liabilities which a banker lends to his customers, whether in the form of notes, or under the rather misleading name of "deposits." This credit, no doubt, is a comparatively fragile and perishable instrument for transferring wealth; but that is no reason for ignoring the fact that, in a modern industrial community, it is the instrument mainly used for this important purpose. The instrument, of course, is not strictly indispensable; commodities might be exchanged directly for each other, or borrowed without the intervention of a medium; indeed some important commodities, such (e.g.) as houses and land, actually are so borrowed. And it may be useful sometimes, in giving a general view of economic facts, to omit the medium of exchange altogether from our consideration; and to represent the persons who purchase goods with 'money' borrowed from banks as *substantially* borrowing the goods from the bankers' customers. But in so doing we should bear in mind how much this simplified view of the facts diverges from the reality; and not mix it up with any statements that aim at representing the facts of exchange as they really are. It is undeniable that, in England now, wealth is chiefly transferred by the intervention of a medium of exchange complex in composition; consisting partly of gold and silver coin, partly of bank-notes, but to a

greater extent of bankers' obligations to pay coin on demand, not represented by notes; and it is chiefly this medium that is actually lent and borrowed in commercial and industrial loan-transactions. And it is no less undeniable that the immaterial part of this instrument has functions precisely similar to those of the material portion; that it is as effective in purchasing goods; and that borrowers pay the same interest or discount for the use of it.

What part of this composite medium of exchange should be classed as "money," and what part (if any) should be classed as "capital," are important questions of definition and classification; but whatever answers we may give to them ought not to prevent us from keeping a clear view of the facts just stated.

§ 3. With the latter of these questions, which has come before us in a previous chapter, we are not here concerned. I have already expressed my opinion that the very important peculiarities of the medium of exchange render it desirable that we should set it aside as something *sui generis* when we are comparing amounts of capital at different times and places. What we are now to consider is the selection to be made for the purposes of economic science among the different uses of "money" which we find to be more or less current. We may conveniently arrange them in order, according to their width of meaning. First will come the narrowest use, which is also the earliest, to denote coined metal. Secondly, we may include besides coin inconvertible paper money which the authority of Government makes equivalent to coin—"fiat-money," as it has been called; or, again, we may take in also bank-notes which are legal tender, under the condition of being convertible into coin on demand. Almost all definitions of money at the present day extend the term so far; while some go further, and include bank-notes that are not legal tender. Finally, there is the still wider signification, which we have found to be current in the language of Lombard Street, though it is not usually recognised in formal definitions, according to which bankers' liabilities not represented by notes constitute the larger part of the so-called money. All these five—metallic money, paper money of all three kinds, and "money of account"—have the same exchange value, are lent and bor-

rowed for the same interest or discount, and in ordinary times are currently accepted in final settlement of all debts—except, of course, the debts of bankers. It seems to be the absence of this latter characteristic especially that prevents bills of exchange from being regarded as money; as the liabilities represented by these latter are always ostensibly to be liquidated at some definite time, so that they are not looked on as finally settling transactions. The same remark applies to exchequer bills, as these are not absolutely convertible into legal tender to the amount they nominally represent, except at certain definite times. Still less, again, are securities, such as Government bonds or railway debentures or shares, regarded as ready money, since there is no time at which they are convertible into coin for a fixed amount: when taken in liquidation of a debt they must always be first sold like any other goods, or at least estimated at a continually varying market value; though, no doubt, as being more conveniently carried and kept, and more readily exchanged than most commodities, they are better fitted for taking the place of money.

Which of these definitions then shall we adopt? It seems to me that, in accordance with the general opinion as to the essential characteristics of money, it is most convenient to take the widest, and include all bankers' liabilities. If the fundamental function of money, upon which its other functions actually¹ depend, is that of being a Medium of Exchange, currently accepted in the settlement of all claims arising out of transfers of wealth; if money is "that which passes freely from

¹ Mr Jevons distinguishes "four functions which money fulfils in modern societies." It is (1) a medium of exchange, (2) a measure of value, (3) a standard of value [i. e. as Mr Walker says a "standard for deferred payments"], (4) a store of value. It is obvious that the second and third uses naturally—though not, as Mr Jevons points out, necessarily—follow from the first.

As regards the fourth function, I agree with Mr Walker in declining to attribute it to money. In a certain sense, of course, any medium of exchange must be also a store of value; that is, each man must keep somewhere, so as to be obtainable without material delay, a sufficient quantity of it for his ordinary purchases. And most of the language in which Mr Jevons explains what he means by a "store of value" appears to me merely to describe a medium of international exchange. "It is worthy of inquiry," he says, "whether money does not also serve a fourth distinct purpose—that of embodying value in a convenient form for conveyance to distant places...at times a person needs to

“owner to owner throughout the community, in final discharge of debts and full payment for commodities, being accepted equally without reference to the character or credit of the person who offers it, and without the intention of the person who receives it to consume it, or enjoy it, or apply it to any other use than, in turn, to tender it to others in discharge of debts or payment for commodities¹ ;” then, in all ordinary conditions of modern commercial societies, bankers’ liabilities, however acknowledged and transferred, are money.

In the above quotation I have altered a single phrase: I have said “from owner to owner” instead of “from hand to hand.” It appears to be the difference between the two phrases which renders the acute and clear-headed writer from whom I have quoted unwilling to recognise deposits in banks as money; since they cannot “pass from hand to hand,” as notes do². But surely when payment is made by means of notes (not being legal tender), the important fact is not the mere physical transmission of pieces of paper, but the transfer of claims on the banker: which is equally effected when payment is made by cheques. No doubt the receiver of the cheque *might* demand payment in notes: but similarly the receiver of

“condense his property into the smallest compass, so that he may carry it with him on a long journey, or transmit it to a friend in a distant country.” But so long as the journey or transmission is within the range of “modern societies” what a man carries or sends is commonly some document transferring to a foreign banker a portion of his home banker’s obligations to pay him money on demand; the foreign banker being ultimately repaid by having transferred to him some foreign merchants’ debt that has been purchased by the home banker. The whole transaction is obviously one of international exchange. But Mr Jevons also explains a “store of value” to mean something that a person “may hoard away for a time;” i. e. something which he does not intend to use for current purchases, but keeps for a remote occasion. In this sense—undoubtedly most appropriate to the term “store”—I must deny that metallic money is adapted to be a “store of value,” or is ordinarily used for this purpose in modern societies. Debts payable before the remote occasion arrives (or portions of capital believed to be readily saleable) are the commodities chiefly used in this way by modern men of business.

¹ Walker, *Money, Trade, and Industry*, p. 4.

² It is to be observed that the question whether bank deposits are money must not be confounded with the question whether *cheques* are. I have nothing to say against Mr Walker’s reasons for answering this latter question negatively; as I regard cheques merely as instruments for transferring the acknowledged bankers’ liabilities which, in my view, are the true money.

notes might pay them in and have the sum added to his account. The former, again, might ask for payment in gold; but so equally might the latter. From neither point of view does there appear to be any essential distinction between the two¹.

Hence it appears to me that one at least of the definitions which we have considered—that which includes bank-notes generally and excludes the rest of bankers' liabilities—may be rejected; as the distinction on which it is commonly based is quite trivial and superficial, and whatever really important differences exist between the transfer of bankers' obligations by notes and their transfer by cheques are important only in certain special questions². If we are to have a definition of money which excludes bankers' deposits, we must either take the characteristic of being legal tender as essential, or we must fall back on the oldest and narrowest usage, and restrict the term to metallic money. Legal currency, however, hardly gives an essential distinction in the case of notes convertible into coin on demand; since the equivalence of such notes to the coin they nominally represent is sustained not by their legal currency (which is of course no protection against depreciation by over-issue), but by the belief that they can be exchanged for coin at will. And though in some countries this belief may be firmer and better grounded where the credit of government is pledged to conversion than in the case of notes issued by private bankers, we cannot affirm this as a universal law: and at any rate the difference of security

¹ In saying this, I do not mean to ignore the important practical differences that exist between payment by notes and payment by cheques. Cheques do not circulate as notes do: the receiver of a cheque commonly pays it in without delay and thus selects the banker whose liabilities he consents to take as money, whereas the receiver of a note usually exercises no such choice. Thus the transfer of bankers' liabilities is more complicated in the former case than in the latter; since, as was before observed, there is a change of bankers as well as a change of bankers' customers: but none the less is the essence of the transaction a transfer of bankers' obligations "in final discharge of debts and full payment for commodities."

² E.g. in considering the need of governmental interference for the protection of the creditors of banks. Here the fact that so far as the note-system prevails a man does not practically *choose* the banker whose obligations he accepts as money, is undoubtedly important.

is only a difference of degree¹. This kind of insecurity of course does not affect inconvertible notes issued by governments; but that is only because they are exposed to the more serious danger of depreciation from over-issue: which renders their inferiority to convertible notes so palpable and so universally recognised that it would be practically very awkward to dignify the former by the title of money while refusing it to the latter.

Metallic money or coin is no doubt distinguished from the other constituents of our actual medium of exchange by the important attribute of being composed of a material that has a high value for other purposes; and also because, except in the case of an inconvertible paper currency, the value of all the rest of the medium of exchange depends on the belief that any given portion of it could be exchanged for coin at will. This fact is sometimes expressed by the statement that metallic money alone has "intrinsic value." But the phrase seems to me misleading; since it is not the difference in the source of the value of coin, confusedly expressed by the word "intrinsic," which is practically important, but the difference in its range and permanence. It is not because coin is made

¹ It is sometimes forgotten that the notes of the Bank of England, though in a certain sense "legal money," are not so in the sense most important to the political economist; since their legal currency would cease, if the Issue Department ceased to give gold for them, and therefore could hardly be effective in sustaining their value, if this ever came to be seriously doubted. No doubt the quality of these notes is unique; in the severest crisis they would be taken as readily as gold. But this is not due to the fact that they are legal tender, but to the special provision made for maintaining their convertibility; and perhaps even more to the general belief that the credit of the English Government is practically pledged to maintain it. And here again it must be observed that the unique position of the Bank of England has now practically an almost equal effect in sustaining the currency of the liabilities of its banking department; in the worst of panics every one has considered "money deposited" with the Bank of England as safe as its bank-notes in his own strong chest.

Hence it seems to me that, in relation to English finance, the definition of money that includes bank-notes generally, and excludes the rest of bankers' liabilities, is specially unacceptable; since it ignores the profound distinction that separates the credit of the Bank of England from the credit of all other banks, while it unduly emphasizes the more superficial distinction between the liabilities of provincial banks that are transferred by notes and the liabilities of the London joint-stock banks that are transferred by cheques.

of a more expensive material that it is a better money than notes; but because it could be used as a medium of exchange over a wider area, and because its value is not liable to sudden destruction through the insolvency of the issuer, nor to sudden diminution in consequence of excessive issues. And it should be borne in mind that these distinctions are not of absolute and unvarying importance; there is no reason why we should not have an international circulation of bank-notes; and the progress of science and industry might so enlarge the supply of gold as to make it possible for a wise and stable government to devise a paper currency of more durable value than gold coin would then be, if still issued as at present.

Still, under existing circumstances, the distinction between metallic money and bankers' obligations—especially in a community that abstains from inconvertible paper—remains fundamentally important; and I should have no objection to restrict the term money to the former, if any short word, sanctioned by usage, could be found for the whole medium of exchange. Since however this is not the case, it seems best to use "money" in the wider signification which it has in the money-market, and refer to metallic money as "coin."

And it must be borne in mind that even this definition is not wide enough for certain purposes; as it does not cover the actual medium of exchange used in foreign—and to some extent internal—trade. The metallic money of commerce is properly bullion, not coin; the latter is used for the payment of foreign debts only so far as it is the most convenient form of bullion. And the non-metallic medium of commercial exchange still consists to a great extent of *merchants'*, not bankers', obligations; that is of bills of exchange; so far as they still circulate among traders, and are not at once discounted. Again, there are certain widely accepted securities—the bonds of some governments, of some railways, &c.—which are so much more convenient for transmission than bullion that they are frequently used as substitutes for bullion in the payment of international debts. When such securities have come to be bought and sold with a view to the fulfilment of this function, to deny that they possess *pro tanto* the most essential characteristic of money, would be to make ourselves the slaves of language.

Since, however, neither merchants' debts nor the debts of governments form a medium of exchange currently accepted by society generally—within a certain local range—in final settlement of debts; it seems to me most convenient to call them not money, but 'substitutes for money.'

This leads me to notice an objection that is likely to be brought against the view above expounded. It may be said that what I have called Money is merely a part of what other economists have called Credit, and that it is more convenient to keep this term as indicating its real quality. And I should quite admit that for some purposes it is important to insist on the fact that bankers' debts are after all debts, no less than those of private individuals. But in a general consideration of the manner in which the functions of money are performed, it seems to me more important to point out that there is as much difference between one kind of credit and another, in respect of its currency, as there is between gold and "goods." If a private individual (A) obtains any valuable article from another (B) by promising to pay for it hereafter, and *does* pay for it, the credit he receives obviously does not operate as a substitute for money at all, in the long run. Only if B uses A's debt to him as a means of purchasing another commodity from C does this credit begin to be a substitute for money: if C uses it similarly in a similar transaction with D, its efficiency as a substitute is doubled. But it is not until such a debt has come to be taken without any idea of using it otherwise than as a means of payment that it has completely acquired the characteristics of money. That this is, in ordinary times, the case with bankers' obligations taken in the aggregate, is undeniable; though (as I have said) the fact is obscured by the continual liquidation in gold of small portions of such obligations.

CHAPTER V.

VALUE OF MONEY.

§ 1. WE have seen in the preceding chapter that the medium of exchange, in a society like our own, with a fully developed banking system but without inconvertible paper, should be conceived as consisting partly of metallic money, but to a much larger extent of bankers' promises to pay metallic money on demand; such promises being partly represented by bank-notes which pass from hand to hand; in England, however, the greater part of these obligations are merely acknowledged in the bankers' books, and transferred by means of cheques. The extent to which bankers' obligations take the one form or the other is determined in England partly by legislation and partly by general convenience; but whichever form they take they are accepted—if they are accepted at all—as of equal value with the gold coin into which they are nominally convertible on demand¹. When depression and mutual suspicion pervade the commercial part of the community, the amount of this immaterial medium of exchange is liable to shrink suddenly, through the distrust and consequent rejection of certain portions of it; so that the superiority in stability of other portions becomes of great practical importance. This superiority may be due to a special connexion between the Government of the society and a certain bank: for instance, we have already noticed that through the special relations existing between the Govern-

¹ It should be observed that many banks pay interest on that portion of their debts to their customers which is not actually used as a medium of exchange within a given period; so that a customer gains by keeping his store of money in this form, instead of keeping it in gold or notes in his own strong box

ment and the Bank of England, the promises of the latter occupy a unique position among the promises of English bankers¹. But however important such differences may be, the most fundamental distinction of all is that between metallic money or coin and promises to pay this money on demand; and it will be convenient to follow this line of division in our investigation of the Value of Money. Accordingly, we will begin by considering how the value of coin is determined.

We have already noticed that the term Value is used in two ways in relation to money; it may either mean (1) the purchasing power of money, or its exchange value measured in commodities other than money; or (2) the rate of interest paid for the temporary use of money. Though economists have sometimes erred in overlooking or misconceiving the connexion between the two facts thus distinguished, they are undoubtedly right in insisting on the importance of the distinction; and it seems best, in a theoretical discussion, to avoid ambiguity by using the term 'value of money' in the former signification only.

On what conditions, then, does the purchasing power of coin depend? In the first place, it should be observed that when the privilege of coining is, as it commonly is, monopolised by Government, it would be possible for the latter to raise the value of coin above what would be sufficient to defray the expenses of production, by limiting the amount coined. In fact this course is adopted by most modern Governments, in the case of coins used for very small payments only; to these a value is assigned, as representing a certain fraction of some higher coin, considerably above the value of the metal used in making them. Such coins are accordingly called 'tokens.' But no civilised government now adopts this plan in the use of coins current for larger payments: since on the one hand any money of which the value depends upon the limitation of its amount is always liable to be suddenly depreciated by large issues, and the resulting danger of violent derangement in the pecuniary relations of

¹ As has already been noticed, this is true not merely of the notes issued by the Issue Department, but also of the obligations of the Banking Department; though the confidence in the latter does not rest on the same grounds as the confidence in the former, and cannot exactly be placed on a par with it.

all debtors and creditors has an injurious effect on commerce and industry; while on the other hand if governments, through necessity or cupidity, are driven to disregard this consideration, they now prefer the far more profitable and hardly more dangerous course of issuing inconvertible paper-money¹.

The question, indeed, that is now practically discussed in reference to coins is of the opposite kind; viz. whether it is not on the whole most advantageous for the community to coin not only *freely* but gratuitously for all individuals who desire it, defraying the expenses by taxation. This, however, together with the further question, how the inevitable loss through wear of the coins in use is to be made good, belongs rather to the Art of Political Economy². Here we will merely assume that standard coins are coined freely for any person who brings gold to the government mint at a charge that at any rate does not exceed the cost of the process; while any serious depreciation of the old coinage, in consequence of loss of weight through wear or ill-treatment, is prevented by prohibiting the use of coins materially lighter than those issued by the Mint.

Under these circumstances we may, without material error, neglect the cost of coinage in considering how variations in the value of coin will be determined; and regard these as

¹ Many economists appear to me, in condemning this practice of "lowering the standard," to use language calculated to mislead. For instance, Mill speaks of Governments "robbing their creditors by the shallow and impudent artifice... which consists in calling a shilling a pound, that a debt of a hundred pounds "may be cancelled by the payment of a hundred shillings." These phrases certainly suggest the popular error that a debased coinage necessarily falls in value in proportion to its debasement, even though the supply of the coinage is altogether under the control of the Government. Whereas such fall, as I have said, depends upon its being issued in excess—but it is to be observed that an amount may be excessive after debasement which was not so before; as a certain dislike of the coin is produced by the knowledge of its debasement, and this, together with the impossibility of using it for foreign payments, tends to diminish the demand for it.

It should be added that the value of token coins is not liable in the same way to depreciation through excessive issue; since the value of a token is intended to be determined entirely by that of the more valuable coin, to a certain fraction of which it is declared equivalent. If however such coins were issued in great excess, they might perhaps be used to some extent in payments of a larger amount than that for which they are legally current; and as so used, they would have a depreciated value.

² Cf. *post*, Book III.

depending entirely on variations in the value of the metal used for standard coins. We will assume in the first instance that only one metal is so used; which we will suppose to be gold, produced within the country that we are considering. Gold, like other products of extractive industry, is a commodity produced simultaneously at very different costs; the cost of the least remunerative portion of its production tending to increase—so long as other things remain the same—with every increase in the amount produced. As we have seen, so far as industrial competition operates, the normal value of such commodities will be affected by any change either in the conditions of supply or in those of demand; a rise in the demand, other things remaining the same, tends to raise the value because the supply cannot be correspondingly increased without having recourse to more expensive production; and on similar grounds any increase in cost of the least remunerative part of the production, demand remaining unchanged, will have a similar effect. It should be observed, however, that the action of industrial competition is likely to be particularly irregular in the case of gold; owing partly to the gambling nature of the industry, of which the returns are extremely various and uncertain; partly to the fact that a large part of it can be carried on with very little capital, so that the calculations of profit that influence its production are likely to be less exact than those made in a business carried on by larger capitalists. Again, in consequence of the great durability of gold, together with the fact that nearly all the gold used as money is practically in the market at any given time, any change in the cost of production is likely to take a long time to produce its full effect on value. “Hence the effects of all changes in the conditions of production of the precious metals are at first, and continue to be for many years, questions of quantity only, with little reference to cost of production¹.”

Let us suppose then that the quantity of gold supplied is given, and that we have only to consider how its value will be affected by the law of demand. The total demand for gold is composed of two elements, which have to be kept distinct in

¹ Mill, III. c. ix. § 2.

considering the law of its variations ; (1) the demand for coin, and (2) the demand for ornamental or technical use. Any rise (or fall) in either demand must affect the value of the whole ; but it will obviously affect it to a less extent than if there were only one kind of demand, as its effect will be partly counteracted by the reduction (or extension) in the other demand, consequent on the change in value. We may assume of course that both demands alike exhibit the general relation of demand to value, extending as the latter falls and shrinking as it rises ; but so far as the demand for ornamental or technical uses is concerned we have no reason to assume any particular quantitative relation between a given change in value and the consequent change in demand.

The case is different with coin. Coin is an instrument for effecting a particular work, that of mediating in (mostly) small exchanges of commodities ; and within large limits that have never been practically overstepped, its utility for this work is not affected by any change in its amount. Supposing the amount of work—that is the aggregate of exchanges made within a certain period for which coin is the medium—to be given, we may assume that the proportion of the coin in the country actually used in doing the work, and the average number of times that the same coins are used over again, will be the same, whether the total quantity of coin be great or small ; at least if we put out of sight the transient disturbing effects that may be caused by a sudden and considerable change in the supply of gold. Hence the exchange value of the aggregate of coin will, on this supposition, remain the same, whatever be its increase in amount ; and accordingly the exchange value of any particular coin will vary in exactly inverse ratio to the variations in quantity of the aggregate.

Now the work that coin has to do is of course continually varying ; it obviously tends to vary with every variation either in the total amount of commodities, or in the extent to which they are bought and sold, or in the extent to which bankers' obligations or other substitutes for coin are used in mediating exchanges. But, so far as we assume persons engaged in industry to act upon accurate calculations of profit and loss, I conceive that in a country where the use of gold

coin is already general¹, a mere change in the quantity of coin in the country—without a concomitant change in the distribution of wealth—would have no tendency to cause a change in the amount of work that it has to do; except transiently, before prices generally have completely adjusted themselves to the changed amounts. A fall in prices occasioned by scarcity of coin cannot, if it be equally distributed, make rational people produce less; nor can it influence them to substitute barter for buying and selling, since neither side has anything to gain by such substitution; nor, finally, can it have any tendency to make them use bankers' obligations instead of coin, since these obligations, being at any moment convertible into coin, must obviously rise in value *pari passu* with the latter. It appears, therefore, that coin forms an exception to the general rule that a scarcity of any commodity extends the demand for its substitutes; and accordingly the law of demand for coin is the exceptionally simple one that the amount demanded varies *ceteris paribus* in exactly inverse ratio to the exchange value². This knowledge, of course, can go but a little

¹ A considerable influx of gold coin into a country with a gold currency imperfectly developed would probably extend the use of coin into backward districts where barter was formerly the custom.

² I may here note an inconsistency, pointed out by Cairnes (*Some Leading Principles*, c. ii. § 2, 3), in Mill's explanation of the term Demand. After laying down generally (iii. c. ii. § 3) that "by demand we mean the quantity demanded," he states, in the special case of money, that "the demand for money consists of all the goods offered for sale." This inconsistency must be avoided; and the best way of avoiding it, in my opinion, is to measure demand for money as for other things by quantity demanded. I admit that it is rather a strain on language to speak of a fall in prices as resulting from an "increased" (or, as I should say, "raised") "demand for money;" when the fact that the phrase denotes is not that the sellers want more money for their commodities at the old rate of exchange, but that there are more commodities to be sold for whatever money they will fetch. But it seems better to submit to this strain on ordinary language and thought in the one case of money, rather than adopt Cairnes' alternative, and measure demand for commodities generally by "quantity of purchasing power offered for them." For this involves an equally marked, and a more extensive and inconvenient divergence from ordinary usage. What men commonly understand by an increase or rise in the "demand for a commodity" is that an increased amount of it is demanded at the price at which it was selling before the increase. No one voluntarily offers to give more for anything than he is asked for it; if he thinks it cheap, he asks for more of it. It is true that the result of such asking, on the part of himself

way towards enabling us to forecast the effects of given changes in the supply of gold; since, as we have seen, this concrete problem contains several other elements, much less easy to ascertain with precision: but, considered abstractly, the law above given is perfectly clear and definite.

It is to be observed, however, that the change supposed in the preceding paragraph is hardly likely to occur in the isolated manner supposed. Any change in the quantity of coin in a country sufficient to affect sensibly its purchasing power is likely also to affect sensibly the distribution of wealth; since it must diminish the real value of all debts contracted and all incomes fixed in amount before the change; and therefore be proportionally favourable to all creditors and all persons whose income varies continually as the market value of their services varies. Now it is quite possible that this change in the distribution of wealth may cause a change in the need of the community for coin: e.g. it may increase the share of produce that is divided into small incomes, whose possessors chiefly use coin in making their purchases, at the expense of the share of the wealthier classes who chiefly use bankers' obligations¹.

Hitherto we have, for simplicity sake, only considered the value of gold in countries where it is obtained directly from mines. We have next to investigate its value where it is a product of foreign trade. As we have seen in the last chapter but one, we cannot exactly say that 'gold tends to have the 'same value everywhere' allowing for the cost of carriage from the mines; since we have to consider not a single but a double cost of carriage, which, in this as in other cases, may be divided unequally between the trading countries; and we have also to take account of the fact that a country does not merely receive gold as an export from countries where gold-mining is carried on; it may also receive it in payment of debt from any

and others, may be that the price is raised instead of the supply being increased; but this result does not seem to me an adequate reason for altering our definition of 'Demand.'

¹ Cairnes has argued (*Essays in Political Economy*, p. 130) that the addition of 40 per cent. to our gold currency between 1851 and 1859 was prevented from affecting prices as much as it would otherwise have done, owing to the increase in the real incomes of the industrial classes in England that took place simultaneously with the increased production of gold.

other country with which it is in commercial relations. Under these complex conditions, all that we can say generally is (1) that the value of gold in a country where there are no gold-mines will tend to be in excess of its value in a country from which it is profitable to import it, by some portion of the double cost of carrying gold one way and some kind of goods the other way'; and (2) that in proportion as the products of a country are keenly demanded abroad, this excess will tend to be reduced.

§ 2. So far we have assumed that there is only one metal used for coin, in payments beyond a certain low limit. Let us now examine the effects of using two such metals. In the first place the purchasing power of either will obviously be less than it otherwise would be; so far as the use of the two metals actually takes place and is not merely permitted by law. Secondly, unless either the causes of variation in the supply of both metals are precisely similar, or one metal is more liable to such variation than the other, the chances are that there will be somewhat less variation in annual supply when two metals are used than when one alone is used.

These two effects are independent of the question whether the two kinds of coins are both legal tender, or whether only one is legally current, but the other also is coined and allowed to pass at its market value.

When both metals are coined into legal tender in unlimited amounts, a rate has to be fixed at which they circulate together; since a law enacting that all debts of money may be liquidated by payment in either kind of coin, provided that there is no special contract to the contrary, would be obviously incomplete

¹ Assuming, that is, that the required transfers of gold can be made in uncoined metal, or that the additional value given to gold, through the charge for coining in the country where it is current, is insignificant. This extra value is of course lost when the coin is sent abroad; and therefore so far as the transfers of gold between two countries have to be made in coin, and the seignorage in either country is high, the possible difference between the values of gold in the two countries respectively may be correspondingly greater than is stated in the text; while, again, if the coin transported has to be obtained from the ordinary circulation, the difference in question may be still further increased, so far as the average amount of metal in coins thus obtained is less through wear and tear than the average amount of metal in fresh coins.

without a precise determination of the equivalence of the two metals.

So long as this legal rate does not vary materially from what would otherwise be the relative market value of the two metals, they will obviously tend to be coined and used indifferently; except so far as the choice between them is determined by the convenience of carrying or handling them. But when changes occur in the conditions of supply or demand for either metal, their effects will be importantly different from the effects that would have been produced apart from legal interference. To trace these effects in their proper order, it will be convenient to contemplate a particular case of change; which, for simplicity, we will first suppose to occur in an isolated country, entirely supplied with both metals from its own mines. Let us assume, therefore, that gold and silver are coined freely by Government and made legally current in unlimited amount at a fixed rate throughout this region; and let us assume that this rate in the first instance accurately corresponds to the relative market-values of the two metals, as they would exist apart from legal interference. Let us then suppose that the supply of silver becomes more abundant, the conditions determining the values of all other products remaining unaltered. Then, apart from legal interference, the gold price of silver would rise; but under the circumstances supposed this cannot take place, in the first instance; for no one will exchange his silver in the market for a smaller amount of gold coin than he could get by taking the silver to the mint to be coined. Hence what will happen will be that all the additional supply of silver, which the non-monetary demand will not absorb at the legal rate, will go to the mint; the purchasing power of the whole mass of coin will fall correspondingly, gold and silver being maintained at their legal relative value. As the exchange value of bullion relatively to other wares must of course fall equally, an extension will take place in the non-monetary demand of bullion—gold as well as silver. But as no change is supposed to occur in the conditions of supply of gold bullion, there must be a corresponding diminution in the gold sent to the mint for coinage. If the increase in the supply of silver were not very great or permanent its effects might stop at this point, so that no difference would

manifest itself between the market-rate and the mint-rate of interchange of the two metals; the demand having in fact, under the pressure of governmental interference, adjusted itself to the change in supply. And it must be borne in mind that any such change tends to be transient, not merely through the exhaustion of the new sources of supply, but also through the check given to production by the fall in the value of bullion and coin relatively to other commodities. But if the addition to annual supply be sufficiently extensive and prolonged, the process above described may be carried on until no gold at all is sent to the mint; and then, for the first time (if the process still goes on), the market-price of gold bullion will begin to rise. When this rise has gone so far that the gold coins still in use have actually—through the continued depreciation of silver, which necessarily drags down with it the value of the coined gold as well—become less valuable than the bullion which they on the average contain, it will become profitable to melt them down; and if the same causes continue to operate, this process will continue (unless prevented by law—or even, if the difference between the two rates be great, in spite of legal interference) until the coin used in large payments is entirely composed of the metal that has fallen in value.

It thus appears that the adoption of a double standard will prevent slight variations in supply from affecting the relative market-value of the two metals, as it will tend to produce changes in demand sufficient to absorb their effect. But variations of a certain magnitude cannot be thus counteracted; on the contrary, such variations will nullify the formal adoption of a double standard, and render the currency practically monometallic.

If now we suppose the country contemplated to be in commercial relations with other countries in which the double standard is not adopted, the nullification of the double standard will be accelerated; since then the 'non-monetary demand' for gold in the country with a double standard will be partly a demand for exportation to other countries where the value of gold is not legislatively tied to that of silver.

§ 3. It remains to consider how the value of that other part of the medium of exchange, which consists of bankers' obliga-

tions to pay metallic money on demand, is normally determined. The answer to this question is, however, comparatively simple; since so long as this ideal money is currently exchanged by bankers and other traders for the coin that it nominally represents, it cannot be currently believed to have either less or more value than the latter. And since the value of coin, as we have seen, is completely determined by (1) the supply, (2) the non-monetary demand for bullion, and (3) the work that coin has to do, it clearly cannot be raised by any issue of bankers' obligations except so far as this affects the third of the above-mentioned determinants by diminishing the customary use of metallic money. Now of course this diminution is a great permanent result of the existence of banks; bankers' obligations being used where metallic money would otherwise be required, the demand for, and therefore the value of, the latter is correspondingly less than it would otherwise be. This seems almost too obvious to be worth stating; but it would appear to have been imperfectly apprehended by the majority of writers on currency a generation ago, who agreed in insisting on the importance of regulating the bank-note currency so as to make it "conform exactly to a metallic standard¹." For if they meant that the value of bank-notes must conform to the *actual* value of the coin they nominally represented, the result would seem to be sufficiently secured so long as the convertibility of the notes is maintained; while if they desired to make the value of notes and coin conform to what *would have been* the value of coin if no notes had been used, their attempt was manifestly chimerical. It is impossible to estimate the extent to which the value of gold would have been greater than it now is, supposing that bankers' (and merchants') obligations had never been used as substitutes for coin; because it is impossible to say precisely how far the actual development of exchange, which would have occasioned this rise in value, would have taken place if the more convenient medium of exchange, afforded by these obligations, had never come into use.

It is clear, then, that that increased use of notes or cheques in the place of gold, which accompanies the development of the

¹ Cf. Mill, B. III. c. xxiv. § 3.

banking system, must by diminishing the demand for metallic money render its value less, and prices consequently higher, than would otherwise be the case. But this change in the commercial habits of society will generally be gradual¹, and cannot, I conceive, be promoted by the direct action of banks at any given time. Where banking expedients are familiar and easily accessible, a banker cannot, by the mere act of making a large loan in his own notes, induce any one to use notes who would otherwise have used coin; any more than he can induce traders to give more bank-money for goods than they believe them to be worth in gold. I conceive therefore, that at any particular time, all that banks can do in the way of raising prices is simply to enable merchants to act on mistaken beliefs that goods are, or are about to be, worth more in gold than will prove to be the case; and in consequence to make extended purchases and raise prices. In this way, no doubt, they render possible alternations of inflated and depressed prices, which could not occur if everything were paid for in hard coin and no credit were given, and could not occur to so great an extent, even if merchants gave credit as at present, if there were no such possibility as the banking system affords of increasing the generally accepted medium of exchange². How far it is desirable that Government should control the operations of banks, with the view of preventing these fluctuations in prices, is a practical question that does not now concern us; but it may be observed that at any rate the banks have no interest in producing the mistaken beliefs that tend to inflate prices. No doubt they profit by them directly through the greater demand for their

¹ If bankers in any country have been prevented by law from issuing notes at all, or notes below a certain nominal value, a removal of such legal restriction may no doubt cause a sudden enlargement of the medium of exchange, and a consequent rise in prices generally. Such a rise will be chiefly only temporary, as it will tend to be reduced, *ceteris paribus*, by a reduction in the amount of coin; still its effects will be to some extent permanent, as the increased use of bank-notes will make the demand for coin less than it would otherwise have been.

² It is to be observed that as all purchases in wholesale trade are customarily made on credit, any extension of purchases involves in the first instance chiefly an extension of *traders' obligations* to pay money at a future date. Hence the extended use of bankers' obligations occurs somewhat later than the rise in prices, which it sustains rather than produces.

commodity; but the danger of the collapse when the mistake is discovered decidedly outweighs this gain.

§ 4. It may be laid down, then, that the amount of bankers' obligations which the banks can get accepted and generally used as money is determined by the real and supposed needs of their customers; who want as much of this money as is required for all purchases too large to be conveniently mediated by gold. The aggregate amount of such money, so far as it constitutes a substantial addition to the medium of exchange at any given time, might be ascertained by adding the amount of bank-notes in the possession of other persons than bankers to the 'current' or 'drawing' accounts of the customers of banks—excluding the accounts that some banks keep with others in the way of business—and subtracting an amount equivalent to the bank-reserves of gold¹. One important way in which this aggregate is increased², in the present state of English banking, is by the bankers discounting bills of exchange for their customers, or advancing them money on securities; since the money that thus comes into the customer's possession is generally at first money of account, and therefore constitutes an addition to the liabilities of the whole aggregate of banks; and it will not necessarily cease to be such an addition when it has been transferred by cheque to some other customer of the same, or some other, bank. No doubt in any particular instance the whole sum

¹ This subtraction is necessary, because, so far as the banks keep gold, a corresponding amount of their obligations should be regarded rather as expedients for saving the wear and tear of coin, than as substitutes for coin in mediating exchanges. I may observe that all but some 15½ millions of the notes of the Bank of England are in this position, so long as the restrictions of the Act of 1844 are maintained.

² According to the ordinary view, the current accounts of banks are increased by persons 'depositing money' there. And no doubt, so far as coin and bank-notes are deposited, this effect is produced; and in the earlier stages of development of the banking system such deposits are of primary importance. But in England, at present, the money is chiefly deposited with bankers by means of cheques, dividend warrants, &c.; and it is evident that by depositing these a man merely transfers to his own banker the obligations towards himself that other bankers have incurred, together with the right of collecting corresponding sums of money from these other bankers. And the total effect of this process on the aggregate of banks cannot possibly be to increase the amount of "money of account" which the banks supply.

may be drawn out in gold or notes of the Bank of England¹; still, on the average of a number of such transactions, in a society in which the amount of exchanges made, and the corresponding need for the medium of exchange, is continually growing, a certain proportion of these additions to the aggregate of bankers' liabilities will tend to be permanent. This will take place especially in times of marked activity of trade, since an unusually large amount of the medium of exchange is required for the more numerous and extensive purchases of goods that are then made. At such times, therefore, the demand of traders for bankers' obligations rises: and here as in other cases the rise in demand tends to cause at least a temporary rise in value of the commodity demanded. But it must be observed that the value that thus rises is not the "value of money," in the sense in which we have been using the term—since the trader does not commonly purchase with goods the money he requires;—it is what for distinction's sake I have proposed to call the "value of the *use* of money," i.e. the rate of interest on loans of money². I have already noticed that in the discussion of this latter value we are liable to find a double confusion; or rather two different confusions, made by two different sets of persons. The exchange value of the use of money, estimated in money, is more or less vaguely confounded by practical men with the exchange value of money relatively to goods; and it is more definitely and deliberately identified by Mill and other economists, with the rate of interest on capital generally. In favour of the former fusion of meanings there is somewhat more to be said, as we shall presently see, than economists have generally allowed; still, it is impossible to justify it completely; and, so far as I am aware, it has never been expressly justified by any writer. There is no reason why the rate of interest on loans

¹ The notes would not usually represent bankers' debts. Cf. p. 259, note (1).

² The money given for a bill of exchange—that is, for an obligation to pay money at a future date—is substantially *lent* by the banker: though Mr Macleod is no doubt correct in pointing out that the transaction is formally a purchase and not a loan. The uncommercial reader should take note that as the money paid for such a bill is equal to the amount of the bill with the discount subtracted, the rate of interest obtained by the banker on this money is a little higher than the rate of discount.

of money, and the power of money to purchase goods, should always rise and fall together; indeed, it is not difficult to shew that, to a considerable extent, they tend to vary in opposite directions. For an active demand for discounts on bills or advances from bankers tends, as I have said, to raise the value of the use of money; but so far as such money is mostly wanted to pay for extended purchases of goods, the increased supply and more active employment of it is generally accompanied by a rise in the price of the latter and therefore by a fall in the purchasing power of money relatively to goods. Similarly in slack times, when bankers have to make loans at very low rates, the purchasing power of money, relatively to goods, is likely to be high; for though at such times money is said to be "plentiful," what is meant is that the amount that bankers have to lend is larger than usual relatively to the demand; but since at such times there is a general lack of enterprise in trade and in the industrial investment of capital, the demand for loans is still likely to be small in comparison with the amount of production of goods.

On the other hand, the grounds for identifying the rate of interest or discount in the money-market with the rate of interest on capital generally are obvious and plausible, and at first sight may easily appear conclusive. Since it is the essential characteristic of money that it is continually being exchanged for all other kinds of wealth—how, it may be asked, can competition possibly lead to the payment of a price for the use of money, different from that which is paid for the use of any portion of such capital; supposing, of course, that the capital itself is estimated at its money value? The answer to this question is somewhat complicated. In the first place, it must be remembered that interest on capital generally, as it was before defined, has to be kept carefully distinct from the other element of profit which goes to remunerate the labour of managing capital. When money is borrowed from the public for a long period or for permanence, by governments or great joint-stock companies, the price paid to the lenders for the use of it may be regarded as entirely interest in this technical sense; since such lenders do not generally obtain any remuneration for the trouble of looking after their investments. But loans made for

short periods by professional lenders of money must yield the latter some "wages of management" as well as strict interest; on this ground, therefore, we might expect the rate of discount on bills of exchange to be higher than the rate of interest on capital generally. On the other hand, we have to consider that the banker to a great extent produces the money he lends, viz. his own obligations, which so long as his business flourishes he is practically never compelled to redeem; and that he may easily afford to sell the use of this commodity at a price materially less than the rate of interest on capital generally. Hence so far as he increases the extent and security of his business by lending his money chiefly to traders for short periods, competition may force him to make such loans at a rate not above—or even below—that of ordinary interest on capital permanently, though not less safely, invested. And this seems to be actually the case; partly, perhaps, because traders are specially important customers of banks; but chiefly because it is convenient for bankers to lend money which the borrowers are bound to repay after definite short intervals, in order that they may at any time reduce easily the amount they have out on loan, if exceptionally large payments are required of them. Thus we have no ground for saying *a priori* that the rate of discount charged by bankers on mercantile bills will be—even on the average and after all allowance for differences of risk—the same as the rate of interest on capital generally; there is no economic reason why it should not be more than this, since the banker has to be remunerated for his trouble: and on the other hand there is no reason why it should not be materially less, if the value of the advantages above-mentioned is considerable; since a comparatively low rate of interest on the medium of exchange inexpensively produced by the banker himself would be sufficient to give him normal profit on his banking capital¹.

¹ The average Bank of England rate of discount on first-class short bills for the ten years 1869—1878, inclusive, was £3. 8s. 7d. which is equivalent to a rate of interest *per cent.* of £3. 10s. 6d.; and I understand that the average market-rate of discount on first-class bills was decidedly less during the same period. (See Palgrave, *Bank-rate in England, France and Germany*, c. 5.) It would seem, therefore, that the interest obtained by bankers generally on the money invested in such bills has been materially less than the interest obtainable during the same period on permanent investments of as high a degree of secu-

It should be observed that, so far as money is lent professionally by persons outside the banking system, interest on loans for short periods will generally be higher than interest on capital or 'money invested' permanently, because it must furnish the money-lender with remuneration for his trouble as well as interest on his capital. And further, so far as industrial competition operates, the discredit that has often been attached to the money-lender's business must tend to raise the price of his loans still further; such discredit being largely due to the fact that in an early stage of industrial development borrowing is not carried on regularly by producers as a matter of business, but is rather an expedient to which producers and consumers alike resort in occasional emergencies or in consequence of unthrift; the money-lender therefore is in the invidious position of making a profit out of the calamities or vices of his fellow-men.

We may conclude, then, that even the average rate of interest or discount current in the money-market will not generally tend to coincide with the average yield of invested capital. And the divergences between the fluctuations of the two rates will probably be still more marked; since the rate of discount is immediately acted on by vicissitudes of trade which only affect the other rate secondarily, and, in ordinary cases, comparatively slightly. The two rates, however, will *ceteris paribus* tend to rise and fall together; since a fall in the yield of investments generally, other things remaining the same, will induce bankers to purchase bills at a lower rate of discount, as they will gain less by investing in other securities, and will render the borrowers of their money less disposed to pay the old price for its use; and similarly a fall in the rate of discount, occurring independently of a fall in the yield of capital generally, will increase the inducement to buy and decrease the inducement to sell securities of which the interest has not risen; and therefore will cause a fall in the rate of interest on such investments actually received.

city—such as first-class mortgages or the bonds of the great railway companies. And so far as banks lend money for longer or more indefinite periods, as "advances on securities," they always, I believe, charge interest considerably above that charged in discounting the best mercantile bills. Hence in the argument in the text I have confined my statements to the rate of discount on bills.

§ 5. Here we may conveniently take note of certain connexions between the purchasing power of money and the rate of discount, which go some way to explain, though hardly to justify, the common confusion between the two meanings of "value of money." It must be borne in mind that money is largely employed not in buying the consumable products and materials of production which we call 'goods,' but in purchasing land, houses, or other portions of capital with a view to interest; especially the debts of governments or joint-stock companies, or shares of the capital owned by such companies, which we call by the general name of 'securities.' Now a fall in the rate of discount will, as we have seen, tend to be accompanied by a rise in the selling price of such investments; that is, by a fall in the purchasing power of money relatively to securities generally (varying in degree, according as the securities are more or less negotiable). Thus when money is 'cheap,' in the ordinary commercial sense, i.e. when discount is low, securities will *ceteris paribus* be dear; and thus the rate of discount and the purchasing power of money will naturally be blended into one notion in the minds of persons whose attention is especially directed to the market for securities.

In the same way when the rate of discount rises the selling price of securities tends to fall correspondingly, under ordinary circumstances. This tendency, however, is likely to be much intensified if the rise in discount is occasioned by the arrival of the first stage in a commercial crisis,—that is, if it is due not merely to the keenness of the demand for loans but to a positive restriction of credit owing to a more or less wide-spread fear of bankruptcies. For under these circumstances the difficulty of borrowing money is likely to cause an extensive sale of securities, as the easiest way of obtaining what is required for the payment of debts; and consequently the selling price of securities tends to fall; and may even fall more than in proportion to the rise in the rate of discount.

But again, under the same circumstances, traders who are in pressing need of money to meet their liabilities are likely to try to obtain it by selling commodities as well as securities; consequently at such times commodities generally are likely

to be cheap, so that "money" will be "dear" both in the economic and in the ordinary commercial sense.

Finally, it should be observed that those who confound the two meanings of "value of money" are not wrong in supposing that the value of the use of money tends to be lowered by an unusual influx of metallic money or bullion, and raised by an efflux; they are only wrong in overlooking the transitoriness of these effects. An increased supply of gold, not accompanied by a corresponding increase in the work that coin has to do (or a rise in the demand for gold otherwise caused), tends ultimately to lower the purchasing power of money relatively to commodities generally; but, in the first stage of the process that leads to this result, the increment of coin—or in England of notes representing the new gold in the Issue Department of the Bank—must pass through the hands of bankers, and so increase the amount of the medium of exchange that they have to lend. Hence the price paid for the use of money will tend to fall, and this fall to cause increased borrowing, and consequent extended use of the medium of exchange; and then through the resulting rise in prices generally, the greater part of the new coin or bank-notes will gradually pass into ordinary circulation. Thus the fall in the purchasing power of money, consequent on an influx of gold, will normally establish itself through an antecedent and connected fall in the value of the use of money.

In the same way, when gold has to leave a country where the banking system is fully developed, in payment of commercial and other debts to foreigners, it will generally be taken chiefly from the reserves of banks; and the need of filling up the gap thus created will make it expedient for bankers to restrict their loans, and so tend to raise the rate of discount. This effect will generally be greater, the smaller the reserve of metal kept by the aggregate of banks, compared with the amount of the medium of exchange that they supply: hence it will be especially marked in such a banking system as our own, in which nearly the whole reserve of gold is kept by the Bank of England.

§ 6. It remains to discuss the determination of the value of 'fiat-money'; i.e. inconvertible notes issued by government,

and purporting to be equivalent to a certain amount of coin. Such notes are sometimes said to have a "forced currency" (*cours forcé*); by which it is not meant that the members of the community are legally compelled to use them as a medium of exchange—no civilised community would tolerate such an interference with freedom of contract—but that they are made legal tender at their nominal value for the payment of all debts of money not contracted under the express condition that they are to be paid in coin. By this measure, and by undertaking to receive such notes at their nominal value in payments of taxes and other debts owed by private individuals to the public treasury, governments are able to secure for this kind of money practically complete currency as an internal medium of exchange.

The exchange value of such money—of which the cost of production is of course insignificant—depends entirely on the relation of the supply to the demand. If the amount coined in any country exceeds the amount of convertible notes of similar nominal value, which the country in question at the particular time would use¹, the purchasing power of the whole medium of exchange will tend to fall just as it would if there had been an equivalent addition to the amount of coin in the country. The rise in prices, which is another aspect of this fall, will tend to increase the imports and decrease the exports of the country, and thus to cause an exportation of the standard coin—which for simplicity's sake we will suppose to be gold—to pay the balance due. If the excess in quantity of the currency still continues, the pressing need of gold to pay commercial debts abroad will cause it to be sold at a premium. When this premium has once established itself, the gold coins used in ordinary payments within the country will have a premium also: but, as the above reasoning explains, and as experience

¹ This supposes that the government does not withdraw from circulation any part of the coin in use. If the amount of such coin be diminished by the action of the government, a corresponding additional amount of room will be made for the inconvertible notes. It is to be observed, moreover, that the government issuing such notes is likely to be making unusual purchases by means of them; which even if made without inconvertible notes would have occasioned a temporary rise in prices and therefore a temporarily greater room for convertible notes than would otherwise be the case.

shows, some time may elapse before an excessive issue of inconvertible notes produces this result. It should be observed, too, that strictly speaking the increase of the medium of exchange through the issue of fiat-money does not tend to cause the premium to be established, until this increase has gone beyond a certain point; since so far as such issue cuts off a portion of the ordinary demand for gold, it has a certain tendency to lower its exchange value permanently. But this tendency will be practically slight so long as the issue is confined to one country.

In the above reasoning I have supposed the region over which the fiat-money is current to be limited, and to have commercial relations with other countries outside it. But even if foreign trade were excluded—or if we suppose an issue of inconvertible notes current over the whole civilised world—the establishment of a premium on gold would still take place, if the issue of inconvertible notes were extended beyond a certain point; only it would take place more slowly and in a different way. What would happen in this case would be, first, a general rise in prices not extending to gold bullion, which would preserve its previous price in coin, and therefore in inconvertible notes. This would lead to an extension of the non-monetary demand for bullion; on the other hand, as the exchange value of bullion relatively to commodities generally would have fallen, its supply would tend to be reduced; and unless these two changes together were so slight that their effect was balanced by the simultaneous reduction of the monetary demand for bullion, a rise in the money price of bullion must ultimately take place. When this rise became so great as to make it worth while to melt down the coin, it would be checked by such melting, until the standard coin had been withdrawn from circulation; but, after this, the premium on bullion would correspond exactly to the general fall in prices resulting from the excessive issue of notes.

NOTE. It has been already noticed that Mr Jevons' theory of the relation between the 'final utility' or final value in use—of a commodity and its value in exchange can not be applied to the case of money. For since money is only used by being exchanged, the value in use of any portion of

it is simply its value in exchange and can be nothing else. Hence, though it is true as we have seen that the value of money tends to fall when its supply is increased, just as the value of any other commodity does; this is not because the new increment of money furnishes an increment of utility or satisfaction less than that still afforded by the previously existing money; but rather because, speaking broadly, the utility of the whole aggregate remains unaffected by the addition to its quantity.

CHAPTER VI.

INTEREST.

§ 1. IN the preceding discussion on the 'Value of Money' in the sense in which economists use the term—i.e. the purchasing power of money relatively to other wealth,—it has seemed desirable to include a consideration of the value of money in the ordinary commercial sense, or the Rate of Interest on loans of money; and this, again, has inevitably led us to speak of the rate of interest on capital generally. It is convenient, therefore, in passing from the theory of the value of products to the theory of the remuneration of services,—or the theory of distribution of wealth, as we at first conceived it,—to commence by examining the competitive determination of Interest; that is, by examining the conditions on which the Rate of Interest would depend in a community like our own, supposing that no one was prevented by Law, Custom, Combination, or a philanthropic regard for the community at large, or for the other party to any bargain, from exchanging his products or services at the highest price obtainable¹.

It is necessary to commence by clearing away some controversy as to the precise nature of the service remunerated by Interest. English economists, since Senior, have generally

¹ The divergence from the facts introduced by this hypothesis does not, as we shall presently see, come prominently before us in the case of Interest; we shall, however, find it a very important consideration when we come to Wages.

agreed to regard Interest as the 'reward of abstinence': but the phrase has been criticised by socialists and semi-socialists, who seem to have understood it as having an ethical import, and implying that the sum paid to a capitalist for the use of his wealth was *just* compensation for the sacrifice he makes in not immediately consuming it. It does not however appear that either Senior, or his chief followers in the use of the phrase, intended any such ethical assertion. All that they meant was that as any individual capitalist could, by the aid of exchange, consume in some form adapted for immediate enjoyment the wealth which he actually keeps in the form of capital, he by abstaining from such consumption renders a service to individuals, or supplies an aid to industry, for which he is paid by interest. The phrase no doubt suggests—what many economists have expressly maintained—that this remuneration is necessary to induce the owners of wealth to postpone their enjoyment of it. And I have no doubt that this inducement is required, under the present social conditions, to keep in existence the actual amount of individuals' capital. But it seems to me better not to imply this belief in our general definition of interest; since circumstances are at least conceivable under which the quantity of capital supplied would be practically independent of the price obtainable for the use of it. It is obvious that the competitive rate of interest on any given amount of borrowed capital would be kept above what lenders might be willing to take, if a sufficient number of borrowers were willing to give it: and it is at least conceivable that the process of saving might be carried on to an adequate extent for no other 'remuneration' than the satisfaction derived from having a provision for the future needs of the person who saves, or of his family or others whom he may desire to benefit.

We will therefore begin by simply regarding Interest as the share of produce that falls to the owner of Capital as such; including under the term not merely the price that is actually paid to the owners of capital which they do not personally employ; but also what employing capitalists earn as capitalists and not as employers. In this latter case, however, such interest is only distinguished by abstract analysis from that other element of an employer's profit, which we have called his

“wages of management”; to learn what part of the earnings of a man of business is to be called interest, we have to ascertain how much he could get for the use of his capital, supposing he withdrew it without loss from his business and lent it to other persons. Thus it is the rate of interest actually paid on borrowed capital which immediately determines the theoretical interest—as distinct from employer’s profit—of the capitalist who is also an employer: it is therefore convenient to begin by investigating the conditions that determine the former¹. Such interest—so long as the rate remains unchanged—will vary in direct proportion to the amount of the loan, if its duration is fixed, and to the time, if the amount is fixed; but we shall follow usage in signifying by the ‘rate of interest’ the proportion of the price paid to the value of the capital borrowed for a certain fixed time, which we will take (according to usage) to be a year.

This definition, however, requires further explanation or qualification in two points. In the first place, we have already seen the need of distinguishing the rate of discount or interest in the money-market from the rate of interest on capital generally; since the two rates, though connected, are not identical, nor altogether determined by the same laws. Of course, when a loan is made, what is actually borrowed is in most cases the medium of exchange; but it is only when it is borrowed from persons who do not make a business of dealing in money, that the price paid for the loan may be regarded as substantially paid for use of the capital purchased with the money borrowed. The interest paid to professional lenders of money must, as was before observed, include remuneration for the labour of such persons; and this remuneration is obviously not Interest in the sense with which we are concerned with it in the theory of Distribution: while on the other hand so far as such lenders are also producers of the greater part of the medium of exchange at a cost considerably less than that which maintains the value of the coin that forms the remaining part—as we have seen to be the case with bankers—competition

¹ As will presently appear, the course of this inquiry itself will lead us to extend our view to the capital that is employed by its owner for a profit no less than to that which only yields interest.

may force them to make loans for short periods at a rate even lower than that at which money or capital is borrowed from the public generally. It must therefore be borne in mind that our present investigation relates primarily to this latter rate; and only secondarily and with the qualifications already noticed to the former.

Secondly, we have to take into account that there is a large amount of capital not formally *lent*, of which, nevertheless, the yield is to be regarded as interest and not profit; since the capital is owned by persons who spend no labour—or at least no remunerated labour—in managing it. This is the case (e.g.) with the capital of railway companies, water companies, gas companies, and many other large masses of capital owned in joint-stock: no one who becomes a shareholder in such companies considers any trouble he may take in electing directors and criticising their report as a sacrifice requiring remuneration; hence the dividends of such companies are to be regarded as merely interest on the capital owned by the shareholders, no less than the money annually paid to the bondholders¹.

Again, it has been before observed that what we commonly speak of as the 'capital' of such companies frequently includes portions of land: and that the distinction which, in considering social production, we drew between capital and land in its original condition, has *primâ facie* no application when we are considering the question of distribution. The real capital of an individual is rarely to any great extent the actual results of his own labour; and so far as he has purchased or inherited it, there is no obvious reason why he should concern himself to inquire whether it was the result of the labour of the person

¹ It may be said that though ordinary shareholders in joint-stock companies obtain no remuneration for the labour of managing the business of the companies, they do obtain the remuneration of higher dividends for the labour spent in careful selection of investments. And this is no doubt true, so far as such labour results, on the average, in a more accurate estimate of the risks of different investments. But since the remark applies as much to different investments of money formally lent as it does to money employed in purchasing shares, it seems more convenient to draw attention to this remuneration of labour at a later point of the discussion. Cf. *post*, pp. 278, 9.

who sold or bequeathed it. And in fact, though the yield of land is more ordinarily called Rent than Interest, still when any one buys land, he regards the rent as interest on the money invested; and it seems best to adopt this view for the present, reserving for the next chapter the task of examining any important characteristics peculiar to the determination of the yield¹ of land.

So again, the rent paid for the use of houses,—at least when the tenant belongs to the richer classes and the house is let for a considerable period of years,—is often merely interest on the capital invested in the house, together with compensation for its deterioration during use, and for the risk of loss from various causes².

In considering the rate of interest on land we have to deal with a point of some subtlety as to the right mode of measuring the amount of an individual's capital. We ordinarily measure capital, as we measure wealth generally, by its exchange value; so that if any particular investment rises in value during the period investigated—as land, on the whole, has continually done—we ought (assuming that there is no cognizable change in the purchasing power of money) to consider the additional increment of value as a part of the annual yield of the investment, no less than the rent or interest nominally received. Similarly in the case of investments of which the price has fallen, we ought to subtract the difference from the interest or dividends which have been paid to the investors. But when we examine the conditions of such changes in the selling value of investments, we find that one important cause is a change in the rate of interest itself. If the rent of a piece of land were to remain the same while the current rate of interest fell from

¹ As will presently appear, in dealing with the (approximately) uniform rate of interest with which we are concerned in the present chapter, the chief controversies as to the theory of rent do not come before us.

² In the case of the small houses let, often in portions, to poor tenants, the rent generally includes a considerable remuneration for the trouble and annoyance of collection, as well as a higher insurance against risk of loss. And a speculative builder expects—and on the average, we may suppose, is able—to get somewhat more than ordinary interest in the net returns on the part of his capital invested in finished houses; the extra yield being gained by his skill in selecting situations in which houses will be likely to find a specially keen demand.

3 to 2 per cent., the price of the land would *ceteris paribus* rise 50 per cent. Ought we then to regard this as constituting a real increase of wealth? When I was considering a similar question from the point of view taken in the preceding book, I answered it in the negative: since the command over the necessities and conveniences of life possessed by the community is, speaking broadly, no greater because the exchange value of its instruments of production has risen in consequence of a fall in the rate of interest. But from the point of view of the Theory of Distribution the correctness of this answer is at least doubtful; for though it is true that the real income of the owner of the capital is not increased by the change, his power of purchasing consumable commodities has certainly increased, though he can only exercise it by spending his capital. At any rate this kind of increase of nominal wealth should be carefully noted and distinguished from other kinds; but for the present we may conveniently avoid any complication arising out of it by considering our problem *statically*, not *dynamically*; that is, by assuming that the rate of interest remains the same during the period investigated, and analysing the forces that determine it to this stable condition. Similarly, for simplicity's sake, we may assume that there is no appreciable change in the purchasing power of money.

§ 2. Here however another question is forcibly suggested, which it is desirable to answer fully before proceeding further: viz. how far, and on what grounds, we have a right to speak of "a rate of interest" as current at any given time. It is notorious that capital is borrowed contemporaneously at very different rates by different individuals and companies; and such differences are still more striking when we include under the notion of interest—as we have seen reason to do—the dividends paid on the joint-stocks of companies. For such dividends actually vary from 20 per cent. or more down to zero: and when we include changes in the selling value of the investments during the year, the variations are increased manyfold, since the lower limit becomes a considerable negative quantity. In what sense, then, can we speak of a tendency to a uniform rate of interest at a given time and place?

Here, firstly, it is to be observed that in so speaking we do

not mean by "rate of interest" on any investment the proportion of the annual yield to the capital originally invested, but the proportion between the dividends or interest actually paid and the present selling price of the stock or bonds upon which it is paid. We can affirm no general tendency to uniformity in the former ratio. No doubt if we supposed all capital to have been originally invested with equal knowledge and foresight, we might infer that the yield of equal portions of capital would in the long run be equal, if they were invested contemporaneously or at times at which the current rate of interest was the same. But in order to draw even from this hypothesis any inference with regard to the proportion of present annual yield to capital originally invested, we should have to know in every case the amount received in previous years; since some forms of capital are more liable than others to depreciation through various causes, so that their yield in the earlier years after investment has to be proportionally greater; while other investments again take some time to rise to their full height of profitability.

And this leads us to the further qualifications required even for the proposition that the rate of interest on new investments, or old investments estimated at their present value, tends to be the same. What the statement means is that all differences in the rate of interest so estimated, on securities currently sold in open market, correspond to differences in the general estimate of the probabilities of fall or rise in the future yield or the selling value of such investments'. So explained, the proposition follows *prima facie* from the principle that in all pecuniary transactions each person concerned seeks the greatest pecuniary gain to himself; and there is scarcely any broad and simple deduction from this principle which approximates so closely to the actual facts of existing societies. It is generally true that men in buying debts and shares are solely influenced by the desire to get the greatest amount of interest that they can on the whole; so that if any one prefers an investment that at present yields a lower interest than another, it is because he either considers it safer or expects it to rise hereafter.

The chief exceptional cases may be classed under the fol-

¹ Mill's phrase "indemnity for risk" is not sufficiently general to cover all cases.

loving heads. (1) Some kinds of securities are purchased at a higher price than would otherwise be the case, on account of some indirect pecuniary advantage obtained by the possession of them. E.g. securities widely known and esteemed safe, for which the demand is extensive and steady, and the value in consequence comparatively stable, have a special utility for bankers and merchants, as a means of obtaining money in an emergency; again such securities (as we have noticed) are, to a certain extent, used for the payment of commercial debts in foreign countries, and have thus a special utility as an international medium of exchange. Either of these causes will have a certain tendency to raise the average price of the securities affected by it. (2) To some extent, again, the price of certain investments is raised through the operation of motives which though self-regarding, act counter to the desire of pecuniary gain. Thus the price of land in England is undoubtedly kept up by the social consideration and power that its possession confers; and again, it is probable that investments reputed especially safe are purchased at a rate of interest lower, as compared with that of somewhat less trusted securities, by a difference somewhat greater than what would exactly represent compensation for the extra risk of the latter; because most persons who live chiefly on interest would suffer from a decrease of income more than they would be benefited by an increase; and again, the freedom from anxiety that safe investments give is itself a utility which has a certain price. It is to be observed, on the other hand, that the excitement of fluctuations of gain and loss is a source of keen pleasure to many minds; as is shown by the extensive existence of lotteries, gaming, betting, and speculation in stocks by private persons. It seems to be the fact that on this ground, indemnity for risk is not even sufficiently represented in the price of some very fluctuating investments¹. (3) Again,

¹ If we had only to consider investments made in view of the investor's personal interests, it would perhaps be a delicate matter to balance the influence of the pleasures of excitement against that of the pains of anxiety. But in the investment of savings for posterity the former motive does not come in; here therefore it seems likely that, on the whole, security will be rated somewhat above its exact pecuniary value. And the same would, I think, be true of investments made by trustees, even apart from the legal interference that actually restricts them to certain funds and stocks; since trustees are much more likely

the effect that would follow from a spontaneous willingness to pay an extra price for specially safe investments will equally tend to be produced, if a certain portion of the capital of the community is kept in such investments by legal compulsion; as is the case in England with a large part of the funds held by trustees. (4) Finally, in some cases, a diminished rate of interest is accepted out of regard for the public wellbeing or sympathy with private individuals. Thus considerable sums are from time to time invested in undertakings of a semi-commercial, semi-philanthropic character, which are not found by experience, and not expected, to bring in even ultimately interest at the average rate; and money is often borrowed from relatives or friends by struggling men of business, at a rate which very inadequately represents the risk of loss.

The two latter causes of variation in the yield of capital are of the kind that we are now supposing absent; but even if we take them into account, it still remains true that the differences in the rates of interest obtainable at any given time on different fresh investments of capital are mainly¹ due to differences in the generally estimated prospects of change in the interest or selling value of the respective securities. This varying prospect is in the majority of cases a prospect of possible loss: the interest accordingly is above what would be paid for a loan of which the repayment was considered absolutely secure. In this way, for example, the interest on the ordinary stock of a prosperous railway company, taken at its selling value, comes to be generally somewhat higher at ordinary times than the interest on its 'Preference' stock or shares; this latter again being somewhat higher than the interest paid on the debentures of such a company²; while the interest on to be blamed for diminishing the funds entrusted to them by hazardous purchases than praised for increasing them by lucky hits.

¹ Even the high price of English land and Consols, though partly attributable to the motives above-mentioned, is to a great extent due to the common belief in the special security of both, and to the expectation, founded on past experience, that the value of the former will rise hereafter.

² Joint-stock companies frequently lay by a certain part of their proceeds to form an insurance-fund against risks. In this way they diminish the hazard of their investments, and proportionally raise the ratio which the selling value of their shares bears to the annual yield; but they do not profess to make such investments "as safe as the Funds:" there still remain indefinite risks of

the debt of the English Government would undoubtedly be less than this last, even apart from the other influences which, as we have seen, tend to raise the price of 'consols.' In such cases, evidently, the surplus receipts represent the general estimate of adequate insurance against the different risks of loss.

So far as such expectations of probable loss (and in some cases, of increased yield) are on the average well founded, it is evident that, on the whole, after a sufficient lapse of time, the differences in the original yield of different investments will have been compensated by the realisation of the expected gains and losses; so that the aggregate interest on the whole capital will prove to be about as much as would have been obtained if it had all been lent on perfectly good security—allowance being made for any extra price currently paid for special advantages of safety (as before noticed). Persons of superior knowledge and foresight will of course tend to get considerably more from their investments, by estimating more accurately than others the risk of undertakings which, from their novelty or some other cause, are rightly regarded as hazardous by prudent persons without special knowledge. Such investors, in fact, obtain a certain return for the skilled labour that they perform in estimating the prospects of novel or otherwise hazardous undertakings; and if we could assume that this labour is, on the whole, undertaken by fairly competent persons, we should infer that the yield of such undertakings would on the average exceed that of safer investments by an amount sufficient to provide adequate remuneration for such labour. But it seems very doubtful how far this inference would be true of any actual society; since ignorant, rash and credulous persons investing in novel undertakings are believed to get, on the average, considerably less interest than if they had lent their capital on perfectly good security—in fact will not unfrequently be found to have lost capital as well as interest. At any rate we may say that the rate of interest on newly borrowed capital which was generally believed to be perfectly secure, would at any given time be nearly uniform, and—after allowing for the extra price of special safety—would represent approximately extraordinary losses through depreciation or destruction of capital, which investors undoubtedly take into account.

the common expectation of the average yield of all capital that was at that time being invested; supposing that there was no general expectation of a permanent rise or fall hereafter in the rate of interest, or in the purchasing power of money¹. It is then with the rate of interest so understood, the expected average yield on freshly invested capital, that we are now primarily concerned. Of course in the case of any particular individual who is not an employer of capital, a fresh investment will generally be effected by purchasing some debt already contracted, or a share of some capital already in existence. But such investments are mere transfers which disappear when we are considering the aggregate of individuals' capital; from this point of view a fresh investment on which interest is paid must imply either the contraction of a new debt, or the formation by a joint-stock company of new real capital in addition to the old, the value of this latter being assumed to be kept up.

§ 3. Let us now proceed to analyse the causes which determine the rate of interest as above defined. In considering this question, we may apply, *mutatis mutandis*, the principles laid down in investigating the general theory of the value of products. In the first place, we may assume that the use of capital is a commodity of which the amount demanded and the exchange value will vary inversely according to some law, so long as the causes of the demand remain unchanged. The legitimacy of this general assumption will probably not be questioned; but the grounds for making it will become more explicitly plain when we examine in detail the different kinds of demand. So far, then, as we may assume the amount of capital seeking employment at interest to be determined independently of the rate of interest, the price obtained by the

¹ If either the rate of interest or the purchasing power of money were generally expected to rise or fall in the future, the relations of the rate of interest on loans of money with perfect security to the expected average yield of capital would become more complicated; since the price paid for the use of money would vary with the length of time for which it is borrowed; and the price of investments expected to yield a high profit at once for a short time would vary correspondingly as compared with the price of those of which the yield was likely to remain more uniform or to rise hereafter. But since it would seem that no such general expectation has ever yet influenced ordinary investors, it is hardly worth while to develop these more complicated relations in detail.

owner for the use of his capital must vary with the intensity of the demand for it. So far, however, as the supply of such capital varies with the price obtainable for the use of it, the determination of the rate of interest will depend on the conditions of demand and supply combined, just as the normal price of a material product does. Under these circumstances, we may conveniently begin by examining first the conditions of demand separately; then, having ascertained these, we will consider the conditions of supply and the resultant effect of the two combined.

There are two broadly different kinds of demand for loans; which we may distinguish as Industrial and Non-industrial¹. In the former case capital is borrowed to replace itself with a profit, and will therefore—except where wasted through accident or error—continue to exist; in the form chiefly of improvements of land, buildings, machinery, and raw or auxiliary materials. But the money of A may also be borrowed by B merely in order to increase his expenditure; in which case the commodities purchased by it will be consumed without replacement; and the interest that B subsequently pays to A will be taken out of his share of the produce otherwise obtained².

¹ A case intermediate between the two is the case of capital borrowed to prevent the ruin through temporary pressure of some individual's generally profitable industry, and the consequent destruction of some or all of his capital invested in the industry. This case resembles industrial borrowing in being favourable to the production of the community taken as a whole; but it is rather to be classed with non-industrial borrowing, when we are considering the general economic laws determining the rate of interest that such borrowers will have to pay.

² It is of course possible that the interest of the debt thus contracted may be from the first paid out of the yield of some kind of capital, which for some reason or other the debtor does not wish to sell. In this case the payment will for some purposes be properly regarded not as an addition to interest, but as a mere transfer of interest from the borrower to the lender. But the difference is not important for our present enquiry: since the loan when made will be a new investment of the lender's capital, while its interest will be paid from the yield of an old investment of the borrowers, so that the former will operate in determining the current rate of interest just as much as if the borrower owned no capital.

The dispute whether the debts contracted by individuals, or by the government of a community as far as it borrows from its subjects,—in excess of any capital that the borrower may own—constitute an addition to the whole aggregate of (individuals') capital in the community that includes both borrowers and lenders, turns on a merely formal—if not exactly a verbal—point. If we allow the con-

Loans of this latter kind do not increase the social capital of the community; but they absorb the savings of the lenders no less than loans for productive purposes, and therefore the demand for them operates in determining the rate of interest at any particular time, just as much as the industrial demand. And, obviously, so long as the balance of motives for "saving" and "spending" respectively remains unaltered, the amount of capital thus non-industrially demanded will tend to be somewhat greater or less, according as the rate of interest is high or low. Now it is quite conceivable that the wealth loaned in any society should be chiefly of this unproductive sort; that the employers of the wealth used in production should be almost exclusively owners of it; and that borrowing should be chiefly a resource adopted to meet temporary deficits of income or occasions of exceptional expenditure, or by persons living

ception of *negative quantity* to be applied to capital, we may legitimately say that a borrower without (positive) capital who is under the obligation of paying interest on a debt owns an amount of negative capital equal to the value of the debt to the lender; and therefore that the aggregate capital of the two is not augmented by the transaction. If, however, this conception is rejected as too unfamiliar, we must certainly admit that the capital of the community—in the sense of 'aggregate capital of individual members of the community'—is increased by the kind of loans that we are considering; only we must add that such increase involves a corresponding prospect of diminished income to some other members of the same community.

It should be observed, however, that among the debts which form part of the capital of individuals, that part of the medium of exchange which consists of the obligations of bankers to pay coin on demand, occupies a peculiar position. So far as this money is used not in mediating the transfer of commodities to the consumer, but in the business of production—so far, that is, as the current account of a man of business is kept for the purposes of his business—it would ordinarily be included in an estimate of his wealth employed in production, no less than the coin that he requires for similar purposes; and there seems no reason why it should not be so included. At the same time, so far as no interest is paid by the banker on these current accounts, he receives without deduction the interest of the investments which this acceptance of his obligations as money has enabled him to make. Thus the nominal amount of capital on which interest is paid or earned is undoubtedly increased by the creation of this medium of exchange: and this increase is not balanced,—as it is in the case (just discussed) of ordinary debts—by a correspondingly diminished prospect of income to the banker. But, as has already been said, the interest received by the banker is, from our present point of view, to be regarded as really the price paid by society for the labour of himself and his servants; except so far as it is interest on his own capital.

habitually beyond their means. In such circumstances the only general economic forces determining the price that borrowers will pay and the amount they will demand, would be similar though opposite in direction to those that determine the supply of loanable wealth: here therefore there would be no advantage in separating the abstract investigation of the Law of Demand from that of the Law of Supply: the rate of interest will express the average estimate formed in the community of the comparative advantages of present and future enjoyment of wealth: though the amount of interest actually paid will depend mainly on the extent to which the practical impulses of members of the community diverge from this average estimate. But in a thrifty and progressive community, in an advanced stage of industrial development, the borrowing of producers with a view to profit—including under this term the formation of joint-stock companies in which the public invest—is much more extensive than the borrowing for expenditure: and since the amount of the latter borrowing is to a large extent fixed independently of the rate of interest¹, we may without material error consider this kind of demand to affect the rate of interest merely by absorbing a portion of the savings continually accumulated, and so diminishing the supply of capital available for industrial uses.

Under the general notion of 'non-industrial borrowing' we must include the hiring or renting of the durable wealth which we have previously distinguished as Consumers' Capital; of which private dwelling-houses may be taken as a principal example. The proportion of the price paid for the use of such things to their selling value will tend to vary with variations in the rate of interest—including, of course, besides interest proper, adequate compensation for gradual deterioration;—and the increased need of such articles which accompanies the growth of wealth and population in a community will absorb a certain portion of savings which would otherwise have been invested in industry. The amount thus absorbed will tend *ceteris paribus* to be somewhat greater when interest is low than when it is high;

¹ The borrowing of governments for wars and other emergencies is generally thus fixed: and most of the borrowing of individuals for unproductive expenditure would be unaffected by any moderate changes in the rate of interest.

thus (e.g.) a low rate of interest will give a certain inducement to build more houses and to build them more durably. This will be true, to some extent, of the consumers' capital that is owned by the user, no less than of that which is hired: in either case such wealth is a form of investment of savings which, so far as it is managed economically, must be affected by changes in the yield of investments generally. But the economic comparison of present to future utilities, made by purchasers of such durable wealth for personal use, has not commonly the exactness of commercial calculations: and on the whole the changes in extent of demand for increased consumers' capital that would result from changes in the rate of interest are probably not great in proportion to the whole demand; so that the rate of interest on capital held in this form, in a modern industrial society, may be regarded as mainly determined by the relations of supply and demand of capital industrially invested, no less than the rate on loans of money for unproductive expenditure.

§ 4. I pass, therefore, to examine the nature and operation of the industrial demand for capital in any community. This demand, so far as it leads to the actual payment of interest, is the demand of persons wishing to employ the capital of others. But its ulterior cause lies in the existence, and recognition by such persons, of unoccupied opportunities for profitably employing capital in industry: and since a portion of the aggregate of such opportunities is continually turned to account by the savings of capitalists who are themselves in business, and employ their own new capital; it seems best to include this portion in a general view of the whole industrial demand; and similarly to include the savings employed by their owners, in our view of the whole supply offered at any time to meet the industrial demand. It should be observed, however, that the actual employment of capital in industry is likely to be somewhat different, according as the employer is or is not also the owner. Employers may sometimes invest their own savings when they would not borrow: either because they are reluctant to incur the relatively more serious loss of income that would result from borrowing if the investment failed; or because, if they can only borrow on personal security, they may be unable to obtain a loan except

at a rate too high to leave them an adequate remuneration for the trouble of managing the borrowed capital. On the other hand, the field of *apparently* profitable employment tends in one way to become greater the more the capital is borrowed; since enterprising employers and promoters of companies will—without any bad faith—be more inclined to run risks with other people's money than they would be with their own. And on the whole, in a broad view of the determination of interest we may neglect these opposite tendencies, and consider the extent and field of employment of savings as independent of the ownership of the savings.

A further important modification seems to be required in our view of the relation between the supply of capital and the field of employment, regarded as determining the current rate of interest. In the first place, we cannot properly consider the whole addition to the stock of capital made within any given time to operate as a new investment, from this point of view; but only that part of it with regard to which the investor's choice was perfectly free and unfettered. That is, we must exclude all the capital that is from time to time required for the completion of industrial undertakings already begun, so far as such completion is necessary to prevent the loss or diminution of the yield expected on what has already been invested. On the other hand, we must, for a similar reason, include that portion of the capital already invested in any business, which its employer could withdraw without affecting the productiveness of the remainder: since such capital is manifestly just as available for fresh investment as capital newly produced. We may perhaps designate what we have in view by speaking of the portion of capital—old as well as new—that is 'fluid' or 'floating' at any given time. The portion of what is already invested to which this term can be applied may be very different at different times in the same business; and the average proportion of floating to non-floating capital varies very much in different branches of industry; such variations depending partly on the different lengths of time for which capital is invested, partly on the extent to which it exists in a form adapted solely for the use of the particular industry in which it is actually employed, or is available for one or other of the new

opportunities for investment that present themselves¹. It should be observed that there is no broad separation between "floating" and "non-floating:" that is. the loss that would be incurred by the removal of non-floating capital from a business is different for different portions; and, in fact, may vary from zero upwards to the whole value of the capital. Hence any rise in the rate of interest, caused by an increase of opportunities of new profitable investment would *ceteris paribus* tend to increase the amount of capital that it would be on the whole profitable to withdraw from old investments; and this increase of supply would tend somewhat to check the rise. Still it is only the supply of capital actually floating that can be regarded as directly operative in determining the rate of interest.

Let us consider, then, that at any given time there is a *quantum* of floating capital, of which—in the sense before explained—the rate of interest tends to be the same; and that the industrial demand for this is furnished by the whole aggregate of recognised opportunities for employing it profitably, which, at any given time, the existing aggregate of non-floating capital leaves open. As we have before seen², the general function of capital employed in industry is to enable the ultimate net produce of labour to be increased by processes which postpone the time of obtaining it; for the adequate realisation of which function the skilled labour of employers, managing labour and capital in combination, is generally

¹ The distinction drawn in the text between "floating" and "non-floating" capital appears to me to require to be substituted, in this and similar discussions, for the received antithesis of "fixed" and "circulating" capital. I do not deny the importance of this latter distinction—as illustrated (e.g.) by the difference between instruments that aid in making many successive products of the same kind, and materials that are spent in making a single product and of which therefore the cost has to be repaid from the price of that one. But for our present purposes this is not the distinction required. Capital in this sense "fixed" may easily have, in a given case, the quality that I have expressed by "floating;" buildings, for instance, may be transferable without loss from a less to a more profitable business: whereas materials may be non-transferable, as they may be only useful for making a particular species of product—nor can it be said that when one set of materials has been exhausted another need not be purchased; since the purchase may be necessary to utilise capital fixed in machines, &c.

² Book I. c. v.

required¹. Now the most profitable manner of effecting this combination in any community tends to vary continually, as the available labourers increase in number, and the capital in amount, while the arts of manufacture, communication and conveyance progress and spread; but we may lay down that in a given state of the industrial arts in a given country, the amount of capital that employers will find it expedient to combine with a given amount of labour, will tend to be somewhat greater or less, as the rate of interest falls or rises. When interest is low, other things being the same, the cultivator has an inducement to employ more instruments in proportion to his labourers; the trader can afford to hold stocks of goods for a longer time; there are more profitable openings for new lines of railway and other investments involving large outlay for distant returns. And so, conversely, if we suppose the amount of capital seeking industrial employment to increase, while the recognised modes of employing it profitably remain unchanged, we may infer that the rate of interest will be lowered, until it reaches the point at which it will seem just worth the employers' while to use the additional increment of capital. In this way the rate of interest on floating capital generally will tend to be equal to the ratio borne to the last increment of such capital by the value of the average additional produce expected to be obtained by employing it,—allowing for the varying interval that may elapse before the produce is obtained, and subtracting what we may call the 'employer's fee'; i.e. the portion of produce that the employers of capital will retain as their remuneration for the labour of management. How the amount of this portion is competitively determined we will consider more particularly in a subsequent chapter²; meanwhile we may lay down that, given the supply of floating capital, and the 'employer's fee' for the last increment of capital, the rate of interest will depend on the extent

¹ Some capital is employed by individual labourers, working on their own account and not employing any hired labour; but most industrial capital is now managed by persons employing some labour,—though the proportion of labour to capital in different businesses varies indefinitely. I may observe that under the term employers we must include the promoters—as well as directors—of joint-stock companies.

² Cf. *post*, c. ix. § 3.

of industrial opportunities recognised as such by employers—which we may call the *effective* field of employment.

It remains to analyse further the conditions that determine the effective field of employment in any country. These are somewhat complex; since, in fact, there is no one of the conditions of production analysed in a previous chapter¹ which may not exercise some influence on it. As the chief elements we may note (1) the natural resources and capabilities of the country, not yet fully turned to account by investments of capital—including in ‘natural resources’ the faculties of labourers not yet utilised; (2) the insight into these resources afforded by the existing condition of industrial knowledge; (3) the industrial and political organization of the community so far as it affords more or less inducements and facilities for acquiring and effectively exercising this insight—as (e. g.) by a better or worse administration of justice, governmental interference more or less wisely directed, a better or worse banking system, provision for general or technical education, &c. &c. The more obvious and striking cause of an ample field of employment is found in the natural resources of a territory, thinly colonized by an advanced industrial population, where the amount of capital already invested is proportionally small. But in considering this cause we must avoid the mistake of supposing—what the metaphor in our term ‘field’ perhaps suggests—that each new investment of capital tends, in proportion to its amount, to diminish the remaining field: no doubt it has this effect so far as it occupies a particular opportunity; but it may easily operate to a considerable extent the other way, by creating new opportunities. For instance, in the present state of industry, after a certain amount of capital—mainly agricultural—has been invested in a new country, it becomes profitable for the first time to invest further capital in a railway; and then, the railway being made, further investments of agricultural capital become profitable, which were not so before. Similarly, when agriculture has developed to a certain extent, extensive employment of capital in manufactures becomes profitable, then, in consequence, further developments of agriculture, and so forth.

¹ I. c. iii.

But again, supposing that the available natural resources—as at present understood—were fully turned to account, and that population did not increase, the field of employment, as recent experience has shown, might be enlarged¹ indefinitely by the progress of Invention, opening out new ways of obtaining economic gain by expending labour for remote results. While, again, if we suppose that the arts of invention—including under this term the discovery of new lines of trade, and any other modes of improving the whole system of cooperation through exchange—remain stationary; and also that the habits and faculties of the working part of the population, so far as these are important in production, undergo no material change; the industrial demand for new capital at the existing rate of interest could only be kept up by increase of population. If this increase did not itself tend to alter the average efficiency of labour, or the share of the produce of labour that the employer of floating capital is able to secure, there would obviously be a demand of uniform intensity, so long as other conditions of production remained stationary, for an increase of capital proportioned to the increase of population. But we cannot assume generally that such an increase of capital would have no effect on the productiveness of labour. Indeed, as we have seen², in a country so thickly populated as England it may be assumed that, apart from improvements in production due to other causes, the economic loss through diminished return from agricultural labour would outweigh the economic gain from increased facilities for cooperation; while a part of this last-mentioned gain would be appropriated by the owners of land and other capital so invested as to be partially exempt from the depreciative effects of fresh competition; so that each increment of capital accompanying and proportioned to an increment of population would be somewhat less productive to its employers than the preceding increment, and would therefore tend to yield a somewhat lower rate of interest. On the other hand in the societies economically the most advanced, improve-

¹ It should be observed that I speak of the field of employment as “enlarged,” when there is room for more capital than before at the same rate of profit; not when more is employed at a lower rate.

² *l. c.* vi. § 3.

ment in the arts of industry is actually progressing continuously and rapidly; and the new inventions that are continually made, including the extensions of international trade, are mostly of such a kind as to enlarge the field of employment for capital. It is not easy to ascertain the balance of these conflicting tendencies in any given country at any particular time; still less can we predict with any definiteness their probable operation in the future; especially since, as I have before said, the progress of invention may conceivably take a decided turn in the direction adverse to the employment of capital.

§ 5. Let us now pass from considering the factors of the demand for capital to investigate the conditions of its supply. Here we have to notice a new element of complication. In investigating the demand for capital in any country, it did not seem necessary to go beyond the limits of the country in question. It is, no doubt, a problem interesting in itself, to compare the different fields of employment for capital furnished by different countries, and to examine how far these differences are due to each of the various causes which, as we have seen, co-operate in producing them. But there is no necessity to discuss these topics, in order to answer the question considered in the previous section; since the field of employment for capital in one country is not directly affected by the co-existent field in another: though it is no doubt indirectly affected by the actual increase of capital elsewhere, through the new opportunities of trade thereby presented. When, however, we come to consider Supply, the case is different; since the attraction exercised on capital by foreign fields of employment is, in an economically advanced country like England, one of the most powerful causes of variation in the supply for home investment. In the present state of the machinery of communication and international exchange, the most enormous masses of capital can be transferred with the greatest facility from one country to another: and it is quite conceivable that this mobility of capital may before long reach a point at which the rate of interest will be approximately the same in all civilised countries, for equally safe investments; so that the whole civilised world will admit of being regarded as one community, for the purposes of the present investigation. And we may conveniently begin

by supposing that this consummation has been attained; and accordingly examine the conditions of supply of capital in an isolated region, out of which issues no overflow of wealth for foreign investment, while over the whole range of it money can be borrowed at the same rate of interest on equally good security.

The investigation, thus defined, is one which we have already had occasion to make in examining the Laws of Production¹. We then saw that the conditions of more or less rapid accumulation of capital are extremely complex. In the first place, the amount that may be saved by any community within any given period tends to be increased, *ceteris paribus*, by any cause that increases the real income of the community during that period; that is, by anything that increases the proportion of the number of effective workers to the whole population, or the average productiveness of their labour. Secondly, the proportion that is actually saved of the whole amount available for saving depends on the resultant effect of the very various motive forces, that prompt respectively to present consumption of wealth and to provision for future consumption. For instance, the proportion between 'saving' and 'spending' tends to be affected by any variation in the degree of foresight and self-control, of capacity for being influenced by remote pleasures and pains as compared with those near at hand, possessed by average members of the community; or, again, in the habits and sentiments that move men to provide for posterity; or, further, so far as men save (as many in the wealthier classes would seem to do) not for any definite end but because their income is larger than is needed to defray their habitual expenditure, any material change in the various habits of luxurious consumption prevailing in different classes is likely to affect saving materially. It did not seem possible to determine, by any simple and definite formula, the general result of the combined operation of these and other causes; there appeared, however, to be reason to believe that *ceteris paribus* saving will increase or decrease in amount, as the rate of interest rises or falls. The amount of effect thus produced within a short period is not likely to be great in com-

¹ Cf. *ante* Book I. c. vi. § 4.

parison with the whole amount of floating capital; so that there will be no material error in taking the rate of interest during any such short period to be determined entirely by the demand for capital. But when we consider the determination of the average rate of interest over a considerable space of time, it is clear that the effect produced on saving by changes in the rate of interest will tend to give this average rate a steadiness which it would not otherwise possess: since any rise in the rate of interest, due to a change in the conditions of demand, has a certain tendency to bring about a subsequent fall through the increase in the supply of capital which it causes; and similarly any fall in the rate has a certain tendency to cause a subsequent rise¹. This *compensatory* or *equilibratory* action of changes in the rate of interest may be assumed to become more powerful, in either direction, as the changes themselves increase in magnitude; and it is probable that, actually, in every existing community there is a point considerably above zero below which the rate of interest could not long remain without some great change in the intellectual, moral, or economic condition of the community, as well as a higher point above which it could not permanently rise, unless we suppose a development of the arts of industry quite beyond precedent. Where, however, these points will be we have no means of determining *a priori*; and I may add that I am aware of no adequate empirical reason for supposing with Mill, Cairnes and others, that the rate of interest in England at the present day is very near the minimum point.

We have thus obtained a general view of the manner in which interest would be determined in an isolated region, over the whole of which the rate was (with the qualifications before given) approximately uniform. Actually, however, we find material differences in the rates of interest maintained in different regions; even where an uninterrupted trade renders it easy to transfer capital from any one of these regions to any other.

¹ It should be observed that experience shows another way in which a fall in the rate of interest tends to bring about a subsequent rise: i.e. by leading to rash speculations, which result in a destruction of capital. This effect, however is due to an irrational impatience of interest below a customary level, which can hardly be taken into account in a theory of competitive distribution.

The explanation of these differences is threefold. First, the general security of capital in some countries, owing to inferiority in political organization or other causes, may be materially less, even for their inhabitants, than that maintained in others. Secondly, there is a certain extra risk incurred by investing in a distant region, owing to the greater difficulty of ascertaining and estimating the dangers that from time to time may threaten the yield of any particular investment, and in taking measures to ward them off. Thirdly, there seems to be a general tendency in the members of any society to estimate the risk of investments in a foreign country more highly, *ceteris paribus*, than that of home investments; owing to their greater confidence either in the morality or in the good fortune of their own community. The extent to which each of these causes will operate, as between different countries at different times, will of course, vary indefinitely. We can only lay down as a general rule, that the yield of capital in any one country (A) does not tend to differ from the yield of capital in any other country (B) which is in permanent commercial relations with the former, by an amount more than sufficient to compensate for the extra risk of investments in B to the inhabitants of A, as estimated by the latter. Thus any new cause that operates primarily to increase the supply of capital, and consequently to lower the rate of interest, in A, tends to have its effect extended over the whole aggregate of countries with which A is in commercial relations; the intensity of the effect being, of course, diminished in proportion to the extension of its range.

§ 6. So far we have considered interest as the share of produce *expected* by the capitalist as such; since it is the *expectation* of profit that determines the action of borrowers and investors; and not, except indirectly, the profit that has been, or is being, earned. If now it is asked how far the actual average yield of newly invested capital is found to coincide in the long run with the expected yield, no precise answer can, I conceive, be given. Indeed, even if we could obtain accurate statistics as to the interest actually received, it would still be impossible to say exactly how much was expected; since no investment is thought to be absolutely secure; and if there were any such, its price, for reasons before given, would probably exceed that

of the less secure by more than adequate compensation for risk : so that there is no means of measuring precisely the amount of risk commonly recognised in those esteemed tolerably safe. We can only say that we have no positive grounds for supposing that the average actual yield of capital already invested tends in the long run to differ materially from the yield expected at the time of investment. Since, however, the yield expected during the first years after investment includes, in most cases, a more or less considerable compensation for risk, it follows that the actual average yield on investments made some time ago will tend to decrease year by year, as the date of original investment recedes into the past. An important part of this decrease, in the case of capital invested in industrial instruments, is due to depreciation through the progress of invention ; in consequence of which the yield of such investments—provided that they are completely exposed to competition—tends to be equal to interest at the current rate (allowing for risk) not on the sum originally invested, but on the present cost of producing instruments equally useful ; which may, of course, be indefinitely less than the cost of the original investment.

There is, however, an important part of the capital of individuals previously invested at any given time,—especially in a community increasing in numbers and wealth,—which enjoys a total or partial exemption from the depreciative effects of competition ; being so invested as to give the employer who uses it, independently of his own skill and foresight, advantages in production unattainable by other employers. In this case there is no reason why its owner should not obtain from it a yield considerably above what interest on the cost of production of the capital would amount to. The most conspicuous case of this is that of capital invested in land. The yield of this to the owner, as we have already seen, goes by the special name of *Rent* : and since the determination of this share of the produce of industry has attracted the special attention of English economists, and is for various reasons peculiarly important, it will be well to devote a separate chapter to the examination of its distinctive characteristics.

NOTE. It may be said that the interest received by members of any one community on capital employed by the members of any other, ought not strictly

speaking to be included when we are discussing how the aggregate produce of the industry of the first community is distributed. But there are two reasons for not leaving it out of account in such a discussion. In the first place even if this interest were merely to be regarded as so much additional income for certain capitalists, the transmission and consumption of which did not directly affect the shares received by other members of the community, it would still tend to affect the latter indirectly: since the mere possession of this extra income, from whatever source derived, tends to give its possessors and their children certain advantages in the competition that determines the relative rewards of the higher kinds of labour—as will be hereafter explained (Ch. ix). But, secondly, since this “tribute,” if it may be so called, of interest is actually paid by transmitting the produce of the country in which the capital is invested, its payment has a direct effect on the whole foreign trade both of the country that sends and of the country that receives it. The exact nature and extent of this effect depend upon the particular conditions of supply and demand of the wares in which the trade is carried on: but, in most cases, it will be beneficial to all the inhabitants of the country receiving the tribute, so far as they are consumers of imports: since the necessity of selling the commodities in which the tribute is paid, in the markets of the receiving country, will tend to establish the equation of international demand at a rate more favourable to the latter than would otherwise be the case. This cheapening of imports may of course be detrimental to certain producers in the importing country; but only as any improvement in industrial processes is liable to be detrimental to some possessors of previously invested capital and acquired skill.

These effects are of course, for the most part, indifferent to the capitalist himself, who may very likely not consume any portion of the commodities in which his interest is paid; and who, if his capital has been lent at a fixed rate of interest, only feels the effects of changes in trade so far as the fluctuations of the exchanges alter the value of the foreign money relatively to that of his own country.

CHAPTER VII.

RENT.

§ 1. THE theory of rent commonly known as Ricardo's, and accepted, with more or less modification, by the majority of English economists since his time, appears to me to combine, in a somewhat confusing way, propositions that rest on different kinds of evidence, and relate to different—and not necessarily connected—enquiries. This combination seems to be partly the effect and partly the cause of the peculiar meaning given to the term Rent in Ricardo's exposition; accordingly, to avoid needless controversy it seems best to begin by considering carefully the right definition of this term.

The term Rent, as commonly used in English¹, denotes the payment made for the use of "immoveables," i.e. either of the surface of land as used in agriculture, or of buildings erected on it, or of the minerals it contains together with the right of removing and selling them. Of course these do not necessarily go together; the proprietor of land does not necessarily own the houses erected on it, and the use of the surface is commonly let without the right of removing any minerals: but the term rent is applied to all three.

The question then arises, 'what (if any) are the economic grounds for distinguishing this from any other payment for the 'use of property.' In the first place we may note a difference in the nature of the obligations imposed in the lending or letting of land, houses, &c., as compared with ordinary loans for which interest is paid. In the latter case, as what is actually borrowed

¹ It may be worth noticing that in French "rente" is used, more widely, to denote any income that accrues without labour on the part of the person to whom it is paid.

is money, there is no particular thing which has to be returned when the loan is repaid, but only an *equivalent* for the sum borrowed; so that here the possibility of deterioration or amelioration of the wealth borrowed does not come in; whereas in the cases where rent is paid, this possibility has to be taken into account; and sometimes, as we shall see, leads to important complications. Still, rent is not the only case of payment for the use of wealth, where the same thing that was originally lent has to be restored when the contract terminates. Such payments (e.g.) are made for the use of carriages, boats, plate, pianos, and other durable articles. The amount of such payment (commonly called "hire"), as regulated by free competition, is not difficult to determine, supposing Interest and Profit determined. Ordinary hire will include compensation for ordinary deterioration through wear and tear of the thing hired, together with interest on its cost of production—including insurance against possible depreciation through invention or change of fashion, and other risks—and such amount of remuneration for the owner's labour of management as industrial competition may allow him.

Why should we not treat the rent of land similarly?

The popular answer to this question is that, since land is not made as carriages are, its value cannot depend upon its cost of production. This answer, however, is obviously superficial; since the material of a carriage is not created by man, any more than the material of a farm; and on the other hand a farm, no less than a carriage, is an instrument that has been adapted to its uses by human labour. Such a farm, in England, commonly contains fences, roads for economizing the labour of conveyance, and buildings for housing cattle and instruments, accumulating manure, and performing the first processes of manufacture on the produce: and further, in many cases, when it was originally made, the land had to be wholly or partially cleared of stones, trees, excess of water, or other encumbrances. Why, then, should not the price paid for the use of land thus prepared and adapted depend upon the cost of such adaptation no less than the price of any other durable product?

To this question Ricardo and others answer that so far as the utility of a farm is the result of labour, the price paid for

the use of it should in strictness of economic language be counted profit or interest¹; the term Rent being restricted to the price paid for the use of the "original and indestructible powers of the soil," or the yield obtained by the owner from this source, where the owner is also the cultivator. There appear, however, to be serious objections to this definition. In the first place, the line that it indicates is one impossible to draw with any exactness in concrete cases, at least in a country that has long been cultivated; and, as Ricardo himself urges, it is in such a country that rent is of most importance. To make this clear, a distinction has to be drawn between the *recurrent* and the *non-recurrent* parts of the expenditure of labour in making a farm. The cost of maintaining the farm when once made, by the repairs needed from time to time to keep buildings, fences, drainage, &c. in good order can be approximately ascertained; and so long as it is profitable to cultivate the farm at all, its produce must yield at least interest on this cost, as well as adequate employers' profits on the movable capital employed on the land. But this recurrent cost is, on the whole, materially less than the total expenditure that would now be required to bring the farm from its original condition up to its present degree of utility; only, as we cannot restore the original condition, we have no means of estimating definitely this non-recurrent expenditure.

This will appear more clearly when it is considered that we should have to include in such an estimate, besides the labour spent on the farm itself, a certain part of what has gone to the making of the roads, canals and railways that connect it with the markets of its produce, and with the places that supply the materials and implements of its cultivation; since the existence of these means of communication is generally necessary to the maintenance of the present value of the produce of the land, and therefore to the maintenance of the rent².

¹ In England this price is hardly, if at all, more than ordinary interest, with a slight allowance for risk; the landlord who spends the money requires little or no remuneration for his trouble.

² It is true, as Mill argues (II. xvi. § 5) that the rent of a farm tends primarily to be reduced by the roads, &c. that connect with its markets other more distant

At the same time I do not doubt—in spite of the difficulty of obtaining exact information—that the rent of land in England is materially in excess of interest (at the present rate) on the cost of bringing it from its original condition to its present degree of efficiency for supplying its markets with agricultural produce. The reason for this is that there is no unused supply of what we may call the ‘raw material of farms,’ viz. land in its original condition, as good—taking both fertility and distance from markets into account—as that of which most of our existing farms were made. There is a good deal of land in Great Britain, not less conveniently situated for supplying markets than much of the land actually under cultivation; but most of it is so infertile that its produce would not pay ordinary profit on the capital required to get out of it anything more than the game or meagre pasture that it at present affords. Similarly there is land in Canada or the United States, not yet brought under cultivation, as fertile as—or more fertile than—any land in England; but its distance places it under the same disadvantage, for supplying English markets, as a lower degree of fertility would do. Hence land in England, of any quality above the lowest, is at a scarcity value; so that a portion of the rent paid for it is undoubtedly due not to the labour spent in fitting it for agricultural uses, but to the appropriation of the raw material to which such labour has been applied. It appears to me, however, misleading to say that this portion is a price paid for the “original and indestructible” qualities of the soil; since, so far as it depends on situation, it is plainly due not to the original qualities of the land but to the development of the human community inhabiting it, and the manner in which this community has disposed itself over the surface of the country.

farms; since these are thus enabled to enter into competition with it and to lower the prices of its produce. But though this is no doubt the immediate effect of making such roads, it is not, I conceive, likely to be the ultimate effect in this case, any more than in the case of any other kind of agricultural improvement; since the increase of population and wealth in the country which these more extended means of communication render possible, tends ultimately to raise the price of the produce of the nearer farm to at least its former height. And, at any rate, the labour spent on the roads that connect a farm with its markets must be admitted to have contributed to raise its selling value and the rent payable for it.

But even if the historical doctrine implied in Ricardo's definition were true, and if the distinction it presents as fundamental could be applied to concrete facts, it would still, I conceive, be hardly relevant in a discussion of the quantitative determination of rent, as an element of the existing distribution of produce. The market-price of a farm—or of the use of a farm—at any given time, does not depend in any way on the ultimate source of its utility; its determination will be just the same whether this utility results from the nature of the soil, or the growth and distribution of human society, or from labour spent with the view of producing it, or from labour employed with other aims.

And even in determining the normal value or rent of such a farm the question of origin only comes in hypothetically, just because such value is raised by scarcity above the influence of Cost of Production. On this ground, while admitting the importance of recognising that ordinary agricultural rent generally contains an element that is to be regarded as interest on the present value of the results of labour previously expended, and another element due to the appropriation of a scarce raw material, it does not seem to me desirable to follow Ricardo in deviating from common usage so widely as to restrict the term rent to the latter. And for similar reasons I shall not follow Mill in separating from agricultural rent whatever part of the price paid for the use of the farm is interest on the recurrent expenditure on buildings, fences, &c., necessary to maintain the fitness of the farm for agricultural uses; since the capital thus invested from time to time is, under ordinary circumstances, as little available for investment elsewhere as the capital spent once for all. The owner of the farm cannot avoid spending it, unless he wishes to sacrifice a large part of the value of his land; the yield of this capital therefore does not vary—as Mill seems to suggest—with the current rate of interest; and there seems no adequate reason for separating it from the yield of the land in which the capital is invested, when we are considering the laws determining normal rent and interest at any given time.

It is, in fact, only when we are considering an altogether different point, the tendency of the value (and rent) of land

to increase as civilization progresses, that it becomes practically important to analyse its utility into different elements, due respectively to the different causes above-mentioned;—though it should be observed that what we are chiefly concerned to know with regard to any particular increase of rent is not whether it is due to labour generally, but whether it is due to labour employed by the owner or occupier.

§ 2. Meanwhile in considering the competitive determination of the rent of land, at any given time, in such a country as England at the present time, we need not generally consider the cost of preparing the land for agricultural and other uses, but only the relation of the supply of prepared land of a certain quality and situation to the demand. So far as this demand is non-industrial—i. e. so far as land is used for purposes of direct enjoyment and thus belongs to the class of things before distinguished as ‘durable consumers’ wealth,’—there is not much use in attempting any minute analysis of the causes that affect its value or rent. We have no simple formula for determining generally how much will be paid for the use of (e.g.) a deer-forest. We can see that it depends partly on the amount of actual and possible deer-forests, partly on the possibility of making a profit out of such land in other ways, partly on the number and wealth of the rich persons who wish to shoot deer and on the comparative utility of deer-stalking and other forms of amusement, as estimated by these persons: but it is hardly worth while to attempt to get further than this.

In the case, however, of land cultivated by farmers for a profit, we can determine normal rent as the surplus which the price of its produce would be expected to afford to a farmer of ordinary ability and industry, after subtracting the farmer’s wages of management, together with interest at the ordinary rate on the capital employed by him upon the land—assuming, for simplicity’s sake that the processes by which such produce is obtained do not materially affect the utility of the land, as an instrument of future production. If the produce in question is of a special kind, of which the supply is naturally limited, while the demand for it is strong; every part of it may have a value above what corresponds to its cost of production (including interest on the landowner’s

capital that has to be from time to time reproduced). Of such produce it may be said that the price of every portion yields a certain proportion of surplus to the owner: or—though the phrase rather tends to confuse cause and effect—that “rent enters into its price.” But in the case of ordinary agricultural produce the supply that can be produced is practically unlimited; only, in consequence partly of differences in the fertility of land, partly (as we have seen) of differences in its situation relatively to the markets supplied with its produce, different portions of the latter are supplied at different costs. In this case, if we assume (1) that variations in fertility are continuous, so that there is no sudden transition from one grade of fertility to another, as the variations in situation clearly are for the most part; and (2) that there is some land in the country worth cultivating that pays no rent—which is approximately true of portions of land actually let, along with other land, to farmers—we may express the law of ordinary agricultural rent in the well-known formula of Ricardo, and say that the Normal Rent *per acre* of any piece is the surplus of the value of its produce over the value of the net produce per acre of the least advantageous land that it is profitable to cultivate; provided the amount of capital employed is the same in both cases.

This last proviso indicates an ambiguity in this formula which has to be removed with some care. It is evident that the surplus remaining, after providing interest on the farmer's capital and remuneration for his labour, will vary with the amount of capital employed. Up to a certain point, which is liable to change with any changes either in the art of agriculture, or in the demand for agricultural produce, the more capital a man employs the greater¹ will be the net produce *per cent.* of the capital employed: but after this point has been reached, the law of diminishing returns comes into operation, and the net produce per cent. tends to diminish as the total amount of capital employed increases. Now it is evident that in a state of thoroughly active and enlightened competition and abundant capital we

¹ In using this term of quantity, I assume that amount of produce is measured by its value. ‘Most productive’ is afterwards used with a similar meaning.

may assume that the amount of capital employed on any land yielding rent would be at least sufficient to make the net produce per cent. a maximum; for if it were not so, it would be obviously profitable to leave the less productive land uncultivated, and apply the capital thus set free in increasing that employed on the more productive. Hence if in any actual case the more fertile land is not generally cultivated up to the point at which the produce per cent. is greatest, it must be either (1) from custom, or (2) from want of enlightenment, or (3) because the best mode of cultivation requires amounts of capital under single managements, larger than average farmers can provide themselves or procure by borrowing. Should these causes operate, rent will actually tend to be determined not by the surplus of the produce of the capital that it would be most profitable to employ, but by the surplus of the produce of what an average farmer would employ.

But further, if, when the most productive land is cultivated so that its net produce per cent. of capital employed is greatest, it is still profitable to employ capital less productively on other land, it must also be profitable to cultivate the more productive land *beyond* the point at which the law of diminishing returns begins to operate; assuming, as we may for purposes of general reasoning, that the diminution in returns is continuous; so that, at the point up to which the net produce per cent. increases, a small increment of capital would but slightly diminish the average net produce on the capital employed. For obviously the extra capital employed on the more productive land will still yield a larger net produce per cent. than capital employed less productively on other land; hence it will be bad economy to employ the latter and not the former, and we may assume that it will not be done, if competition be active and enlightened and capital abundant. And obviously, again, the larger the amount of capital that is thus employed the greater will be the surplus produce, and the greater the rent.

Under these circumstances we may say that the last portion of the capital employed pays no rent; meaning that the farmer does not get, by employing it, any additional surplus which active competition would force him to resign to the landlord.

And we may give the following formula—which is substantially Ricardo's—for the competitive determination of Rent under the conditions supposed: 'The rent of any unit of land (supposed homogeneous in quality) tends to be equivalent to the surplus amount of its average annual produce, when cultivated with as much capital as can be profitably applied to it, over the produce of an equal amount of capital applied to land, under the least favourable circumstances under which it is profitable to apply it.' The capital supposed to be applied under the least favourable circumstances may be either, as Ricardo generally conceived it, capital applied to the least fertile lands in cultivation; or it may be the additional capital applied to good land in high farming, which it is just profitable to apply, though a lower kind of farming would yield a larger proportional return for the smaller capital it would require. And it should be observed that the proposition above stated is an immediate deduction from the hypothesis of perfect competition, taken together with the fact that different portions of agricultural capital are unequally productive from causes independent of the variations of seasons and differences in the farmer's skill: and is in no way necessarily connected with any theory as to the origin of the different degrees of productiveness.

Nor again, as we have already seen, is it necessarily connected with the further proposition laid down by Ricardo, that rent tends continually to increase with the growth of the wealth and population of a country. This proposition, however, appears to me undoubtedly true when taken merely (as Ricardo puts it forward) as the statement of a tendency, liable to be counteracted by improvements in the art of agriculture, or in the machinery for communication and conveyance, or by any other cause that facilitates the introduction of foreign supplies, and when limited to a country in which population has reached a certain point of density. In such a country every increase of population increases the demand for agricultural produce, without bringing with it a counterbalancing gain in production through the increased facilities of cooperation among the denser population; and therefore, so far as it goes, it tends to raise permanently the price of such produce, since the

demand can only be met by applying capital under less favourable circumstances than before¹. But how far rent, in any particular country is likely to increase hereafter from this cause, is a question which we can only answer by a conjectural forecast of the future operation of several economic forces combined; such as (1) the tendency of population to increase in the country in question and elsewhere, (2) the mobility of labour, and (3) the tendency of Invention to increase the produce obtainable from a given area and to cheapen conveyance; in which calculation the last two elements at any rate must be taken as highly uncertain.

§ 3. Hitherto we have assumed that the value of the land is not materially altered by the process of production. It may however happen that by using the land in the way that is economically most advantageous on the whole, the producer will either improve or deteriorate it. No difficulty is thereby introduced in the abstract determination of economic rent, where the producer is also the owner; we have merely in calculating the whole amount of produce to include the increment of value added to the land, along with the value of the products taken from it; and similarly to deduct from produce any decrement due to deterioration. When, however, the producer does not own, but merely farms, the land, this possibility of improvement and deterioration renders it a matter of some difficulty to frame a rent-contract which shall give the farmer adequate inducement to treat the land in the manner most economical on the whole. To illustrate this difficulty let us suppose first that

¹ For clearness' sake it may be worth while to distinguish by different names the three distinct theories, relating to quite different subjects, which are included in what is commonly known as Ricardo's doctrine of Rent. We might call them respectively

- (1) Historical Theory as to the origin of Rent;
- (2) Statical Theory of the actual determination of Rent;
- (3) Dynamical Theory of the causes which continually tend to increase Rent.

The first of these we have seen reason to abandon, on the ground that we have no means of separating from error the element of truth that it contains: the second is as incontrovertible as any part of pure economic theory can be; the third is equally incontrovertible, when regarded merely as the abstract statement of a tendency; but when put forward as a prediction of actual economic change it is merely an uncertain generalization from experience.

the improvement of the land is economically desirable. Here we have to distinguish two different cases. (1) If the farmer, while using the land in the way most immediately profitable, at the same time augments its utility as an instrument of future production, the matter may be simply settled by allowing the increment of value to be appropriated by the landlord; since, in this case, such appropriation has no tendency to prevent the improvement from being made. But (2) if, as is more ordinarily the case, the outlay required for the improvement will not be profitable to the farmer, unless he secures the whole, or the main part, of the gain resulting from the increased utility of the land; it will be his interest to leave the land unimproved unless either he is bound under penalties to improve it, or this gain is somehow secured to him. The former alternative can hardly be made effectual without hampering the farmer's freedom of action to an extent disadvantageous to his industry. Hence, in order that such improvements may be duly made, it will be needful that either (1) adequate compensation be secured to the farmer generally for whatever increment of utility may remain unexhausted when his tenure ends; or (2) a lease be given him—and continually renewed—of such length as always to allow him adequate prospect of reaping the benefit of his improvements; or (3) each improvement be made the subject of special agreement between farmer and landlord—which practically requires the latter, or his agent, to take a certain share in the management of the farm.

A somewhat similar problem is presented in the case where the land is deteriorated by the most economic use of it. This case but rarely occurs in agriculture¹; but it is the ordinary condition of the mining industry, and of certain other branches of production which take from the land products that are not renewed². In such cases the total amount of the produce in question that can be profitably taken from any particular piece of land

¹ Land used for agriculture might doubtless often be deteriorated by treatment which, though uneconomic on the whole, would increase its produce for one or two years. And there would seem to be some practical difficulty in framing a contract to prevent this effectually, without interfering disadvantageously with the farmer's freedom of action—but it is hardly within the scope of the present chapter to discuss this difficulty adequately.

² Such as (e.g.) Peruvian guano, timber from natural forests, &c.

is generally at least so far limited in prospect, that every portion brought to market diminishes proportionally such possibilities of future production as have a definite market value¹. The problem, then, in letting land for the purposes of any such industry is to frame a contract which shall render it not the interest of the lessee to remove and sell an amount of such products greater than what it would be profitable for him to bring to market if he were also the owner. Now if the land in question is leased at a fixed rent, this coincidence of interests will only occur under certain special conditions. Thus, if owing to the state of competition in the industry the owner would be unable to raise the price of his product materially by limiting his supply, if he has no ground for inferring a rise of any importance from the general prospects of supply and demand, and if the cost of production does not become materially greater as the amount produced within any given time increases—it would then be the owner's interest to produce as much as possible, provided that the price of the product were sufficient to pay at least the working expenses of production, including adequate remuneration for the labour of management; and under the same circumstances it would be the interest of a lessee paying a fixed rent to do the same. If, however, the owner would either have reason to expect a rise in price, or be able to produce such a rise by limiting his supply, either alone or in combination with other producers; then it would obviously be expedient for him not to produce beyond the point at which the probable rise in price, present and prospective, would more than compensate for the probable loss incurred by deferring production. But, under these circumstances, it would not generally be expedient for a lessee to adopt the same limit of production; unless the period of the lease were long enough to make it practically certain that the mine would be valueless before the end of it: since otherwise, by stopping at any given point, the lessee would lose the whole gain obtainable on the extra amount that might have been produced, whereas the owner would only lose the interest

¹ This is true even in the case of mines where the prospect of actual exhaustion is too remote and indefinite to be economically important; owing to the prospective increase in difficulty of extraction, at least after a certain amount has been taken.

on this gain for a certain number of years. In the same way it may be shown that if there is a certain amount that can be produced within a given time by the most economic application of labour and capital, while it is still possible to produce more but at continually increasing cost, it would generally be expedient for a mere lessee to extend production beyond the limit which it would be expedient for an owner to adopt. In either of these latter cases it seems impossible, without more foresight of the conditions of the market than can be hoped for, to frame a rent-contract which will have the effect of making it always most profitable for the lessee to treat the land in question in the manner most profitable to the owner; but a rough reconciliation of the divergent interests is attained by the ordinary practice of making the lessee pay—either with or without a fixed annual payment—a certain ‘royalty’; that is a sum proportioned either to the amount of material extracted, or—which is the more suitable arrangement—to the price obtained for it.

It may be observed that a rich mine affords one of the most striking instances that can be found of wealth of which the value is due not to labour—or at least not to labour spent on the valuable thing itself—but merely to its scarcity and utility; since the land containing such a mine rises to a price far exceeding that of agricultural land, as soon as the existence of its contents is known, before the application of any part of the labour that will ultimately be needed to extract them. Another case where the element of labour is practically absent is that of ground employed for dwelling houses in towns; the high rent of which is entirely due to the utility attaching to such ground from its situation.

§ 4. There are various other uses to which land—including the permanent results of labour applied to land—may be turned so as to yield the owner a surplus which might be classed as economic rent. Thus a railroad favourably situated or cheaply constructed is, no less than a farm, an instrument of which land in its preexisting condition may be regarded as raw material; by means of which the commodity of conveyance between certain places is produced and sold at a price that yields its owners considerably more than ordinary interest on the cost of making the railway (including the purchase-money

of the land); because it is either not possible owing to legal obstacles or otherwise to construct an equally effective instrument for the same uses, or at any rate such a construction would be too costly to be profitable. A similar exemption from the ordinary effects of competition is enjoyed by certain other portions of industrial capital, such as the capital of water-companies and gas companies; whose dividends are in consequence considerably higher than current interest on the original outlay. So, again, the immaterial results of the labour of Invention, protected from imitation by patents, frequently yield a similar surplus. Even when the extra profit obtained by using the patent does not amount to more than a fair interest on the value of the labour and materials expended before the invention was perfected; still, as the intellectual result when once achieved does not require renewal, such extra yield is in any particular case determined—like economic rent—without any relation to the value of the inventor's labour. And if it is still possible for persons excluded from the advantage of the patent to use profitably inferior processes of production, the extra yield obtainable by those who use the patent will be determined in a manner exactly analogous to ordinary agricultural rent.

So, again, the extra profit obtained by the Goodwill or Connexion, which gives firms of long standing an advantage in the competition for business, is often very analogous to rent; for though it may broadly be regarded as interest on the cost in labour and outlay incurred without adequate immediate return, during the earlier years of the business; still it is often mainly due to a favourable concurrence of social conditions, and when once acquired it tends to maintain itself by the mere *vis inertiae* of habit, without any extra exertion of skill or energy on the part of those who enjoy the advantage.

In many cases, however, it is difficult to separate the extra yield obtained merely by such established connexion from that which is due to general belief in the excellence of the commodities furnished by the firm in question; and so far as this belief is really founded on the skilful conduct of the business, the additional income obtained by it—whatever may be its ultimate analysis—will be more naturally discussed under the head of Wages.

CHAPTER VIII.

GENERAL WAGES.

§ 1. WE now approach the part of our subject which, especially in recent years, has both excited the keenest practical interest and given rise to the most perplexing theoretical controversy—the competitive determination of the wages of labour. It seems to me most convenient—as it is not unusual—to separate the investigation into two parts; to commence first by asking how the amount¹ of General or Average Wages is determined; and then to proceed to seek an explanation of the differences of wages in different employments. This course is further recommended by the fact that the first of these questions, taken separately from the second, is the one on which English political economists have bestowed most attention².

In the first chapter of this book I proposed to extend the term Wages so as to include the remuneration of all kinds of labour, and I shall ultimately adopt this more extended definition of the term. But since other economists generally denote by ‘wages’ (when used without qualification) the remuneration of labour hired by employers, it seems convenient to adopt this

¹ It should be observed that this is not the same thing as asking what *proportion* of the total produce is allotted as wages. My reason for taking the question as stated in the text will appear later on.

² The reader should bear in mind that throughout both parts of this investigation Competition is understood to exclude Combination, whether of employed labourers or employers. In a subsequent chapter (ch. x.) I shall consider to what extent this competitive distribution is liable to be abrogated or modified in consequence of the action of such combinations with the view of raising or lowering wages.

meaning in the critical discussion which will occupy the first part of this chapter¹.

We may begin this discussion by noticing one way of dealing with the question of wages which very naturally and obviously suggests itself to the mind of reflective persons, and is therefore liable to mix itself more or less unconsciously with any other theory that they may adopt, unless it is openly and clearly expressed and discussed. I mean the view in which labourers are considered as productive instruments requiring a certain quantum of food, clothing, lodging, &c., to keep them in the most efficient condition from birth to death; and this quantum, whatever it may be, including whatever is similarly required to maintain the wives and mothers of labourers, is regarded as their normal share of the social produce. That this is the share that they ought to receive in an ideal state of society is an ethical proposition which may, perhaps, be plausibly maintained; but it is easy to show that there is

¹ It should be observed that Mill, in the chapter (Book II. chap. xi.) in which he treats of "the causes which determine or influence the wages of labour generally," expressly proceeds "as if there were no other kind of labour than common unskilled labour, of the average degree of hardness and disagreeableness." But I am not sure that he quite realises how widely this hypothetical procedure diverges from the actual facts, in such a country as England—in 1867 Mr Dudley Baxter estimated the persons engaged in "agriculture and unskilled labour" in England as little more than a third of the whole class of manual labourers (2,813,000 out of 7,785,000), and their net annual earnings as considerably less than a third of the aggregate earnings of manual labourers (70,659,000 out of 254,729,000). At any rate I think that in the course of his discussion the very hypothetical character of the assumption on which he is proceeding, rather drops out of his own mind, and is certainly liable to drop out of his reader's mind. Thus I observe that, when he passes (in chap. xiv.) to treat of the difference of wages in different employments, he speaks of his previous discussion as having been concerned with the "laws which govern the remuneration of ordinary or average labour," without any notice of the great difference between the average remuneration of labour generally, and the average remuneration of unskilled labour. I observe too that in the chapter in Prof. Fawcett's Manual (Bk. II. ch. iv.), the doctrine of which is mainly derived from Mill, the treatment of the "average rate of wages" makes no reference to Mill's expressly hypothetical procedure, but refers apparently to the average of actual wages. And since it seems best to deviate as little as possible from actual facts in the assumptions on which our reasoning proceeds, I shall mean, at first, by general wages the average remuneration of all the *hired* labour that is actually supplied in a modern civilised community; afterwards, in § 5, extending the term to include all remuneration of labour.

no necessary tendency in a system of free competition to give them just this share and no more. For if the labourer can produce more wealth than he and his family require for necessary consumption, he may obviously, being a free agent, keep and enjoy the remainder; and we must assume that he will do this if he can. It is true that in such a country as England, labourers without any capital could not produce enough to keep themselves alive; still, as capital could not any more be used without labourers, if the combination of the two produces both more than is necessary to keep the labourers in efficient condition (and also more than is necessary to induce the owners of wealth to keep up capital, to the extent required to make labour thus productive), there is no general reason why the labourer should not by free contract secure a share of this extra produce.

Nor can it even be maintained that at any rate the food, clothing, &c., necessary to keep the labourer in the most efficient condition will give us a *minimum* below which the self-interest of employers, if duly enlightened, will not suffer wages to fall. This would no doubt be true if the present labourers alone were concerned and if the employer could actually feed, clothe and shelter his labourers just as he feeds, covers and shelters his horses. But when we consider the labourer as a free and independent citizen, and also as the father of a family, spending at his own discretion a considerable portion of his wages in rearing a future generation of labourers, the case is altered. Suppose that the employer knows that his labourer is under-fed and that half-a-crown a week, spent on nourishing food and warm clothing, would result in more than half-a-crown's worth of extra value in the produce of his week's labour. It does not follow that it is his interest to give him the extra half-crown: for in the first place the labourer may spend a large portion of it in alcoholic liquors, &c., which will impair rather than increase his efficiency; and secondly he may spend a large portion of it in providing better food and clothing for his family; which though it may be amply repaid to society in the additional efficiency of the future labourers whom he is rearing, will not necessarily afford any pecuniary advantage to the employer who may have no

means of securing to himself any of the value of this future efficiency.

Hence it is only under special circumstances—i.e. if the employer has adequate empirical grounds for believing that the higher wages will actually be spent in increasing the efficiency of labourers whom he will himself employ¹—that his self-interest alone can be relied on to secure such provision for the labourer as would make the excess of his produce over his consumption a maximum.

§ 2. The view just discussed has not, so far as I know, ever been adopted by professed political economists. In fact, until recently, these latter, instead of making the efficiency of labour a prominent element in the theoretical determination of general wages, have maintained a doctrine which appears to leave it altogether out of account. This is the doctrine currently known as the Wages-Fund Theory; which in 1869 was “presumed” by John Stuart Mill to be “found in every systematic treatise on Political Economy,” and which remains unretracted and unmodified in the latest edition of his own treatise. The theory is stated by Mill in an essay, in which its inadequacy is admitted, as follows.

“There is supposed to be at any given instant a sum of wealth which is unconditionally devoted to the payment of wages. This sum is not regarded as unalterable, for it is augmented by saving and increases with the progress of wealth; but it is reasoned upon as at any given moment a predetermined amount. More than that amount it is assumed that the wages-receiving class cannot possibly divide among them; that amount and no less they cannot but obtain. So that the sum to be divided being fixed, the wages of each depend solely on the divisor, the number of participants².”

On this view, then, if we say—as those who adopt this

¹ It is to be hoped that many employers, in modern civilised societies, would incur the extra expenditure in the case supposed, even if the chance of securing to themselves a remunerative share of the resulting addition to the wealth of the community did not seem quite worth purchasing at the price, on strict calculations of probable gain and loss. But our deductive reasonings are concerned primarily with the ‘economic man,’—who, though he may be allowed to be philanthropic, must be assumed not to mix philanthropy with business.

² Mill, *Diss.* iv. p. 43, in a review of Thornton *On Labour*.

theory commonly do say—that wages are determined by the relation between the supply of labour and the demand for it, it must be observed that the term “demand” must receive a signification different from that which was given to it in the Theory of the Value of Material Products: since a rise in the demand for labour will not correspond to any change in the general estimate of the final utility of the commodity demanded, but merely to an increase in the funds devoted to the purchase of labour, determined without any regard to the utility of the labour. And wages being thus determined, the determination of general profits is similarly simplified: profits in the aggregate are simply the excess of what the productive labourers produce over what is required to replace their wages. And thus, as was before remarked, the theory of Distribution comes to be treated by Mill and his followers as though it had but slight analogy to the theory of the Exchange Value of products.

The discussion in the preceding chapters will already have shown the reader that I do not adopt this method of treatment. But the Wages-Fund theory has been so widely accepted, and by writers of so much authority¹, that it seems desirable to examine it carefully, and try to fix as precisely as possible the nature and source of the error that, in my opinion, it contains.

In the first place, however, some care is needed to get the doctrine itself quite clear; as the language in which it is expounded by Mill in his treatise is certainly liable to be misunderstood; and has, in fact, exposed him to the charge of presenting an arithmetical truism as an economic law². In the passage (B. II. c. XI. p. 1) in which he first speaks of the wages-fund he seems rather to describe the elements of which the whole sum paid in wages is composed, than to state the law by which the total is determined. “What may be called “the wages-fund of a country,” he says, is made up of “that “part of the circulating capital” of the country “which is “expended in the direct purchase of labour,” together with all

¹ As I have noticed, Mill himself partially renounced this theory (in the review before quoted). His leading disciples however, declined to follow him in this renunciation. See Cairnes, *Some Leading Principles of Political Economy*, Pt. II. c. I.; and compare Fawcett, *Manual of Political Economy*, Pt. II. c. IV.

² Cf. Cairnes, *loc. cit.*

other funds that are paid in exchange of labour. But obviously, if we knew no more of the wages-fund than that it is a total thus heterogeneously composed, the statement that "the general rate of wages cannot rise but by an increase of the aggregate funds employed in hiring labourers or a diminution in the number of the competitors for hire" would be as unimportant as it is undeniable; it would be merely saying that a quotient can only be made larger by increasing the dividend or diminishing the divisor.

What Mill, however, was really concerned to assert was something much more important than this elementary arithmetical proposition. He meant that, since the great majority of the wage-earning class are labourers hired by employers for a profit, the amount of wealth devoted to the payment of wages is mainly determined by the "law of increase of capital," that is, by saving. It was of course always recognized, by himself and his followers, that, strictly speaking, the "capital" of which the increase is important to the labourer is "only circulating capital and not even the whole of that, but the part which is expended in the direct purchase of labour." Notwithstanding this, it was thought a sufficient approximation to the truth to say for shortness that "wages depend on the proportion between population and *capital*." Mill certainly warns his readers that this is an "elliptical not a literal statement": but this and equivalent phrases are used without qualification in the popular manual of one of his most distinguished disciples. "It has been shown," says Mr Fawcett¹, "that capital is the fund from which labour is remunerated. It thus becomes obvious that wages in the aggregate depend upon the ratio between capital and population ... every law concerning wages must be deduced from the fundamental conception of a ratio between capital and population ... if the number of the labouring population remain stationary wages cannot rise, unless capital is increased." From these premises the immediate and obvious inference is that the only two ways of increasing each labourer's share of the annual produce are either (1) to add to capital by saving, or (2) to decrease the number of labourers.

§ 3. Now I am not prepared to dispute the efficacy either of

¹ *Manual of Political Economy*, Book II. c. IV.

increased saving or of decreased population, for the attainment of the desired end of increasing the average rate of wages in England at the present time. But the abstract doctrine from which these practical conclusions are deduced appears to me to be based upon a wrong conception of the nature of the need which labourers have of capital; and in consequence to concentrate attention too exclusively on the above-mentioned expedients for raising wages. I shall endeavour to show this first without rejecting the received view, according to which a portion of the capital of the country is conceived, while remaining capital, to *constitute* the fund that is paid in wages of productive labour; though, as I shall afterwards explain, I cannot but regard this view as inconsistent and confusing.

To begin; it is obvious that any theory, in stating which it is deemed legitimate to use the general term 'capital' to stand for the portion that is paid in wages, treats the ratio in which any given amount of savings may be expected to be divided between wages-fund and other capital as something that may be left undetermined. Now the theoretical incompleteness of this treatment can hardly be denied; but to make clear the practical importance of the point thus passed over, it will be well to consider how large a proportion of the actual capital of this country, in any year, exists in some other form than that of real wages of the labourer. We shall overstate the annual income of the wage-earners by taking it at 400 millions: and we shall much understate the value of the other capital of the employers of these wage-earners if we take it at 2000 millions; but it is quite sufficient for my argument to assume that the proportion of other capital to wages-fund is as 5 to 1. Suppose now that in a year 120 millions are saved and added to the existing capital. In what proportion are we to suppose this to be divided? Mill seems to have tacitly assumed that it would be approximately in the same proportion of 5 : 1; i.e. that out of the 120 millions saved about 20 millions would be added to the wages-fund and about 100 millions to other capital: so that there would be about 100 millions more of improvements in land, machines and other instruments, and raw and auxiliary materials. But then we are met by this difficulty. If the number of machines, &c.

are increased, must not the number of labourers employed upon them be increased in the same ratio? but on the other hand, if the number of labourers are increased in the same ratio, there will be no increase in the rate of wages, unless the progress of industry has increased produce in a greater proportion than the increase of capital, which Mill certainly does not assume—and in fact, as we have seen, Mill's chief recommendation to the labourer is to avoid increasing in the same ratio as capital. Suppose that the labourers carry out this recommendation so effectually as not to increase at all, what will be the result? Will the former proportion of what I will, for brevity's sake, call 'Non-wages capital' to 'wages-capital' be still maintained? The answer that Cairnes, in his development of Mill's doctrine, gives to this question is rather startling. He assumes¹ that the proportion that non-wages capital bears to labour is determined by the nature of the national industries, so as not to vary with the rate of wages. It would seem to follow from this that, supposing capital to be increased by 120 millions and labour not at all, the whole of the 120 millions would be added to the wages-fund. But then unless the labourers became personally more efficient in consequence—which Cairnes does not assume—there would be no increase in the annual produce, and therefore the whole increase in the wages-fund would according to this theory be taken out of profits within the year after the rise. Now, though I do not consider saving to depend so entirely on the prospect of profit as Mill and other economists, still I cannot doubt that a reduction of profits by an amount equivalent to the whole amount saved would very soon bring accumulation to a stop; hence the conclusion from Cairnes' assumptions would seem to be that under no circumstances can capital increase to any considerable extent unless the number of labourers increases also.

In view of this paradoxical result I scarcely think that Cairnes would have maintained the arbitrary hypothesis from which I have inferred it. He would hardly, on consideration, have refused² to admit the general assumption made in the

¹ *Some Leading Principles*, Part II. c. 1. § 8.

² Cairnes afterwards recognises (*l. c.* § 9) that the "industrial development" of a progressive community follows a well-defined course," according to which

last chapter but one, that, given the extent of the industrial demand for capital, the amount that may be profitably employed in aid of labour will not be a fixed quantity; but will tend to be greater or less as the rate of interest falls or rises. It follows that if we suppose an increase to take place in the proportion of total capital to number of labourers, other things remaining unchanged, in consequence of which the rate of wages begins to rise and the rate of interest to fall, we must also suppose, as a concomitant effect, an increase in the proportion of non-wages or 'auxiliary' capital to labour. And again, from this increase in the aid rendered by capital to labour, we must further infer an increase in the average productiveness of labour, and therefore in the annual produce. Hence the increase in the wages-fund that accompanies the increase in the non-wages capital will not be taken entirely, nor perhaps even chiefly, out of the shares of other members of the community; and therefore the accumulation of capital may still go on, though at a somewhat decreased rate. Nay, further, when we are considering the matter from a purely abstract point of view, and not in relation to the special circumstances of a crowded country like England, we must not exclude the possibility that new investments may tend on the average to enlarge the field of profitable employment for capital in some ways as much as they contract it in others; so that, in fact, the increase of capital may increase the efficiency of labour in as great a degree as it increases the wages-fund; and thus not cause any permanent fall in the rate of interest¹.

If this reasoning be sound, it is manifest that we cannot regard the rate of wages as determined merely by taking the "ratio between capital and population;" since this alone helps

"a constant growth of the national capital is accompanied with a nearly "equally constant decline in the proportion of this capital which goes to support "labour." But he treats this change as "the inevitable consequence of the "progress of the industrial arts"; he does not anywhere recognise that the mere increase of capital through saving must have a certain tendency to produce this result, independently of any change in the arts of industry.

¹ In this case the limit for each employer of the amount of capital employed would be determined not by decrease in prospective profit, but by increase in disadvantages of borrowing.

us but little towards ascertaining the ratio between wages-fund and population.

§ 4. But, as was before said, I am myself unable to adopt the view that wages are normally paid out of capital at all. It is no doubt true that a certain portion of capital is always—to use Bagehot's term—Remuneratory and not Auxiliary in its nature: that is, it does not consist of instruments that make labour more efficient, but of finished products, destined for the consumption of labourers and others. This part of capital continually *becomes* real wages (as well as real profits, interest and rent) being purchased by the labourer with the money wages he receives from time to time. But it does not seem to me therefore correct to regard the real wages as capital “advanced” by the employer to the labourer. The transaction between the two is essentially a purchase, not a loan. The employer purchases the result of a week's labour, which thereby becomes a part of his capital; and may be conceived—if we omit for simplicity's sake the medium of exchange—to give the labourer in return some of the finished product of his industry. When this transaction is complete a portion of the capital of the country has undergone one of the transformations through which capital is continually passing; and exists now in the form of the results of a week's labour, having previously existed in the form of finished but unsold products; while by the same transaction the labourer has obtained a share of the produce of industry in return for his labour. This seems to be the only clear and consistent view that can be taken of the payment of wages, according to the line before drawn between “capital” and “produce”: which line, again, appeared to be the only one by which we could make precise the meaning commonly attached to the two terms. Economists who have not adopted this view are liable to fluctuate confusingly between two unreconciled conceptions of wages; at one time speaking of them as “paid out of capital,” whilst at another time calling them the labourers' “share of the annual produce of labour and “capital,” and implying in this and other phrases that “capital” and “produce” are two distinct portions of wealth. This confusion seems to be best avoided by considering the assistance to production rendered by labour—whatever form it may take—

as constituting the real capital of the employer who purchases it; and the commodities that continually pass into the consumption of the labourers as their share of the produce.

To put the matter briefly, "remuneratory capital" does not remunerate while it remains capital. The products consumed by the labourers so long as they are capital, are a part of the stock of traders; when they have passed into the labourer's possession, in return for the results of his labour, they constitute his share of the produce—and if, as we have seen, they may in a certain sense be regarded as capital after that, they are merely 'consumers' capital' of the labourer. Thus we should not regard each addition to the total stock of capital in the country as containing an addition to the wages-fund; but only as tending to increase wages indirectly so far as it (1) increases aggregate produce by supplying industry with additional instruments, and (2) increases the labourers' share of produce, in consequence of the lower rate of interest obtained on the increased supply of capital.

The adoption of the other view proceeds—like so many other economic errors—from a one-sided attention to the more obvious and striking results of investing capital. It is of course true that when a new investment of capital is made, a large portion of the money employed is generally paid in wages to labourers; and the inference is natural, that if it were not for this investment, the labourers in question would not be receiving wages during the period in which the process of investment is going on. But the inference is mistaken; for we must assume, speaking broadly and generally, that the labourers if not employed in this way, would be earning a share of the produce—though a somewhat smaller share—in some other work. It is possible indeed that some of them would have been idle; and no doubt the sudden cessation or depression of any particular branch of industry would throw many labourers out of work; so that, under certain circumstances, the withdrawal of a given amount of capital might conceivably involve a diminution in the real wages of the employed not much less in extent. But this result is very exceptional: and, so far as it occurs, the loss thus caused to the labourers should be regarded as a transient result of the disorganisation of industry, not a per-

manent consequence of the diminution in the amount of capital. Speaking generally, there is no reason for supposing that a larger percentage of labourers will, on the average, be unemployed in a community with small capital than in one with large; only in the former their labour will tend to be *ceteris paribus* less productive, and their command over the necessaries and conveniences of life will generally be less in consequence¹.

§ 5. How then is the share of the produce that, during a normal period, falls to labour, competitively determined? if a mere consideration of the numerical ratio between amount of capital and number of labourers does not help us to determine it. In answering this question I follow, as was before said, the common practice of economists in investigating first the *general* or *average* share that falls to labourers taken in the aggregate. But in one important point I propose to deviate from the common practice, in company with one or two recent writers, and include in the notion of the labour that earns wages all remunerated employment of time and energies; and therefore the exertions, intellectual and muscular, of the employer no less than those of the employed. The reasons why this course is not commonly adopted by English economists seem to be twofold; first, the remuneration of the employer's exertions, so far as he employs his own capital, is actually received by him blended in one lump with the returns to his capital, and can only be artificially distinguished from it by economic

¹ Again, it is of course true that if wages rise the capitalist employers have to spend a larger sum in purchasing the results of a given amount of labour; but then since these results have, by supposition, risen in market value, their capital (estimated at its market value) is correspondingly increased. That thus the capitalists' wealth is not decreased, while the labourers' is increased, by a simple exchange of equivalents, is certainly a paradoxical result; but I have already noticed that this paradox is an inevitable consequence of measuring Producers' and Consumers' wealth together by a common standard. In fact the capitalists' increase of nominal wealth is greater than has just been indicated; since they will obtain an equal rise in value on all similar results of labour which they have previously purchased, so far as their value depends on the cost of reproduction. No doubt, if the labour grown dearer is not really more efficient, their nominally increased capital may not bring them in any more income. But this result will not surprise us when we reflect that, if the labour grown dearer is not more productive, the rise in wages must involve a fall in interest; and it is implied in the very notion of a fall in interest that a larger amount of capital is required to bring in a given income.

analysis; and secondly it is the employer's share that in ordinary thought is most obviously contrasted with that of the employed, as tending to rise when the latter falls and *vice versa*. As regards this second point, it cannot be denied that the interests of employers are so far opposed to those of their employees, that an increase due to certain causes in the share of either class tends to be accompanied by a decrease in the share of the other. But this in no way places the former class in an exceptional position: since similar oppositions are continually liable to occur between the pecuniary interests of different groups of employed workers. Nor, again, is there any *prima facie* ground for assuming that the rate of employer's remuneration and the price paid for the use of capital are governed by the same laws; and there is certainly more affinity between the return a man gets by working in one way and the return he gets by working in some other way, than there is between remuneration for work of any kind and the gains obtained through the mere ownership of the wealth used in industry. Indeed the manager of a joint-stock company, or even of a private industrial establishment, does chiefly the same kind of work as many employing capitalists; and if, as is very likely, he has capital invested somewhere else, he is practically induced to remain a manager, instead of setting up on his own account, by the consideration that he will be better remunerated for his labour in the former position than in the latter.

It may be urged, however, that the ascertainment of the amount of aggregate or average wages, in which we lump together the earnings of employers and employed, will not really answer any question of practical interest; for what both labourers and employers are concerned to know is the amount of remuneration that the two classes respectively may look for, not the amount of produce that is somehow to be divided among them. But here again we may rejoin that any particular labourer is only concerned with the average wages of the whole aggregate of hired labourers in a very indirect way; so far, that is, as changes in this average rate may be expected to extend their effects to the particular branch of industry to which he belongs. And in the same way he is indirectly concerned, in only a

slightly additional degree of remoteness, with the remuneration of the aggregate labour of the society of which he is a member.

The chief advantage of presenting first this more general question is that it brings into prominence an element in the wages-problem which the discussion of particular wages is apt to leave in the background. When we are considering variations in the wages of this or that group of labourers we commonly assume, as it is convenient to do, that the real contribution of these labourers to the whole produce of the community is given, and that what we are concerned to investigate is merely the variation in the amount of the equivalent that society is willing to give them for this contribution. But when we are considering the reward of labour in the aggregate, it is obvious that it tends to be increased, *ceteris paribus*, by any cause that tends to make labour more efficient.

In fact, in the determination of Interest and Rent, as expounded in the two previous chapters, we have by implication indicated how general wages are determined; so far as the supply of labourers is assumed to be given. For what remains after subtracting the aggregate price paid for the use of capital (including land)—whether this be ordinary interest, or extra payment due to any kind of monopoly or scarcity—is obviously the share of labour in the aggregate. As I have already said, I agree with English economists generally in holding that, in such a country as England, this share tends to bear a smaller proportion to the total number of labourers as that number increases; supposing other things, including the amount of capital used in their aggregate industry, to remain the same. But I should state the reasons for this conclusion quite differently from those who adopt the “wages-fund” doctrine, and determine wages simply by the arithmetical ratio between capital and population. In my view this result is due to the fact that if labourers increase in number, capital remaining stationary, the industrial demand for the aid of capital will tend to rise, and therefore the portion of the total produce paid for the use of a given amount of capital will tend to be greater; at the same time the proportion of total produce to the number of labourers will tend to be less, as the loss of efficiency of the capital-aided labour, due to the diminished returns from land, is likely to be

greater than the gain in efficiency from the increased advantages of co-operation¹, while, again, the owners of land and any other employers whose capital is partially exempted from competition, are likely to absorb a considerable share of this latter gain. On this latter ground, again, even if capital increases *pari passu* with labour, the reward of labour will tend to decrease in such a country as England, as its quantity increases; unless some improvement takes place, through invention or otherwise, in the average efficiency of the capital-aided labour. On the other hand any such improvement is on the whole likely to increase the labourers' share of the produce; though it should be observed that different kinds of improvement operate in very different modes and degrees to bring about this result. Improvements in the physical, moral, or intellectual qualities of labourers tend primarily to increase the share of the produce that falls to labour, leaving the share of capital unaltered; and the same is true of all inventions that economize the labour necessary to produce a given result of utility,—whether they are discoveries of new processes in industry or new lines of trade—provided that they do not require the use of an increased amount of capital. The great majority of inventions, however, do require additional capital; and in this case it is possible that nearly the whole gain of the invention may become an addition to the share of the capitalist; it is even conceivable that, owing to the rise in the rate of interest due to the keener demand for capital, the owners of capital generally may obtain an addition to their share *exceeding* the whole extra produce due to the invention. In this way we reach the conclusion that the introduction of machinery, though profitable to the community taken as a whole, may conceivably, in a state of free competition, be temporarily injurious to the interests of all members of the community who are not owners of capital. This conclusion however has little practical application; most important inventions, while increasing the field of employment for capital, have at the same time effected a saving of expense to the community much greater than the addition they have caused to the capitalists' share of the produce. Still the essential

¹ On account of this loss through crowding it is of course possible that interest may not rise even though the average remuneration of labour falls.

difference, from the labourers' point of view, between inventions that merely economize labour without requiring extra capital, and those that enlarge the field of employment for capital, should be carefully noted.

§ 6. Since, however, variations in the number of labourers within a given country tend to have—on whatever ground—important effects not only on the average produce per head of the industry of the country, but also on the proportion in which the produce is shared between labour and capital; it is necessary, in order to complete our view of the determination of general wages, to take into account the extent to which the supply of labour is itself affected by its remuneration, and examine the reaction on the price of labour of this influence exercised by price on supply. As we have before observed, the quantity of labour in a community may vary independently of any variations in the aggregate of its population, from changes either in the proportion of workers to non-workers, or in the number of hours devoted to work in the year. Such changes actually occur to an extent not unimportant, and are often at least partly due to variations in wages: but I do not think that we can say generally that a rise or fall in the price of labour has a definite uniform tendency to increase or diminish the quantity of labour supplied by a fixed quantity of population. We will accordingly confine our consideration primarily to the influence of high or low wages on the increase or decrease of population in the aggregate; only taking note of the effect on the proportion of workers to non-workers, so far as this is inseparable from the effect on aggregate population. We will further suppose, in the first instance, that changes in the remuneration of labour do not materially tend to affect its efficiency.

We may begin by noticing an important case in which the action of price on supply may be neglected without material error, in investigating the determination of wages—the case, namely of a thinly-peopled peaceful country, cultivated, as a new colony is, by methods belonging to the most advanced stage of industry. Here no considerable number of persons are prevented from marrying by lowness of wages; and therefore, so far as native labour is concerned, supply may properly be treated as independent of price. Still even in such

a country the total supply of labour will actually depend to some extent on immigration; and this will be affected by the rate of wages—though probably not to an extent sufficient to react materially on the rate itself. But in a thickly-peopled country—according to the Law of Increase of Population as stated in Book I.¹—we must regard the lowness of the real reward of labour as a continually active check to the increase of population; the force of which is no doubt diminished, but not actually removed, by emigration to other countries where the wages of labour are higher.

The check is actually applied in several very different ways; thus in England, among the upper classes of labourers, it takes almost solely the form of abstinence—prudent or vicious—from matrimony; while lower down in the social scale the restriction of numbers results, to a certain extent, from the mortality among young children in consequence either of insufficient provision of necessaries, or of the absence of due maternal care, in case the mother of the family has to earn wages for its support. In other countries, again, the reduction is said to be partly effected by voluntary limitation of the number of children in a family; and sometimes by legal obstacles to early or imprudent marriages. However, in one way or another, it may be laid down that an effective check is exercised on the great majority of labourers in all European countries by the actual lowness of the remuneration of labour: and under such circumstances, it is evident that if general wages rise the force of the check will almost certainly be diminished, and a stimulus will be given to population of which the ultimate tendency will be to lower wages again. Similarly, if wages fall through any cause, the check will become more stringent; and so, other things remaining the same, wages will tend to rise again, when population has been thereby reduced. In either case, too, the temporary variation in the reward of labour, being partly absorbed by an increase in the number of non-workers requiring to be supported by the workers, is prevented from affecting proportionally the style of living of any class². And if we could assume that the average

¹ Cf. l. c. vi. § 3.

² The causes that tend to maintain different grades of labourers with different standards of comfort, even in a society where competition is unrestricted, will be discussed in the following chapter.

standard of household expenditure in any grade of labourers,—the amount of income on which a man of average prudence would think himself justified in marrying—remained approximately constant; then so long as population was effectively checked by want of means, this habitual standard would give us a normal rate of wages in each class—and therefore *ceteris paribus*¹ of general wages,—round which actual wages would slowly oscillate, just as the market-value of a material product oscillates about its cost of production. In fact we might regard this habitual standard as, so to say, a ‘Quasi-cost’ of Production of labour; being as closely analogous to the cost of production of a material product as is compatible with the labourer’s freedom of choice.

But it need hardly be said that this supposition is only useful to facilitate our general conception of the mutual influence of Supply and Remuneration of labour. The assumption of a fixed standard of living is, of course, quite unauthorized as regards labour taken in the aggregate. If a fall takes place in the ordinary wages of any class of labourers above the worst-paid, from which they cannot be relieved to any material extent by industrial competition, we can hardly doubt that while it will partly cause a diminution in the per centage of marriages, it will also take effect in a lowering of the standard of living; the “Quasi-cost of Production” of the labour in question will be somewhat lowered and therefore though the diminution in the supply will tend to raise wages again, it will only raise them to a somewhat lower point. Similarly, a temporary rise in the market price of labour will have a certain tendency to raise the quasi-cost of production up to it.

Hence we cannot say that the ‘standards of comfort’ of different classes tend to give us a definite normal rate of wages in each class—still less that they tend to give us a normal rate of general wages; but merely that they tend to counteract, to an extent not definitely ascertainable, the causes operating, at any given time and place, to alter the amount of produce competitively allotted to labour.

The doctrine however of a normal—or, in Ricardo’s phrase, a

¹ The average would of course be altered by any social changes that tended to alter the relative numbers of labourers in different grades.

'natural'—rate of wages is more plausible as applied to the case of the worst-paid class of labourers—or, strictly speaking, the worst-paid class of which the supply has to be mainly self-maintained¹. If in any country this class is on the verge of starvation, any reduction in their wages can be only very transient. And it is probable that a rise in the wages of such labourers—though it must, I conceive, have a certain tendency to raise their standard of comfort—would have a stronger tendency than it would in the case of any other class to cause a subsequent increase in the supply of labourers and so *ceteris paribus* to depress wages again. On the other hand, we ought here to take account of an element hitherto omitted from the discussion: viz. the effect of variations in the labourers' remuneration on their personal productiveness. I have so far not introduced this consideration, because, though some effects of this kind are doubtless produced by any considerable change in the wages even of better paid labourers, such effects in the case of these latter are liable to be in diverse directions: high wages increase the inducement to work, but they also enable the habitual standard of living to be maintained with less energetic work, and also tempt to unsalutary indulgences: so that on the whole there does not appear to me adequate reason for assuming as regards labour generally that high wages tend to increase either the quantity of labour per head, or its efficiency. But when we are considering the case of labourers scantily provided with the means of maintaining physical health and vigour, we can hardly doubt that a material rise in wages would partly take effect in improving the productive powers of present and future labourers; and this improvement would tend materially to sustain the rise in wages that caused it. But to attempt an accurate balance of these different tendencies would, I conceive, be idle, so long as we are confining ourselves to this abstract treatment of the question; such a problem could only be satisfactorily dealt with by the help of statistics, and in relation to a particular country at a particular time.

¹ The worst-paid labour of all is that of classes in towns kept up to a considerable extent by the degradation of members of other classes, and therefore unapparently exempted from the economic necessity of keeping up their own numbers.

CHAPTER IX.

PARTICULAR WAGES AND PROFITS.

§ 1. IN the attempt to show how the average wages of labour taken in the aggregate tend to be determined, we have been inevitably led to take note of the differences which normally subsist, even where competition is legally quite open, between the wages of different branches of industry. As has already been observed, it is this latter question which is most interesting to any particular labourer: the variations in an average found by dividing the aggregate of workers' remuneration among the aggregate of workers do not practically concern him, except so far as he may infer from them the variations in the wages that he may himself expect. It might be added that even the average rate of wages in his own industry only concerns him indirectly, unless he is conscious of being an average worker. There is hardly any branch of industry in which a labourer stronger, more industrious, more skilful, or more careful than his fellows is not likely in one way or another to obtain more than the average rate of remuneration. The limits, however, within which such variations in the earnings of individuals are confined vary very much in different industries: they are naturally greater where work is paid for by the job or piece, than where the payment is customarily made for a day of customary length; and they tend to increase as labour becomes more skilled, except so far as this tendency is checked by custom or counteracted by combination.

When the superior labourer works on his own account, the additional remuneration that he will obtain will correspond partly to the greater quantity of work that he is enabled to do by

the more urgent demand for his services, partly to the superior quality of his work so far as this is generally recognised. Similar considerations determine the extra wages that an employed labourer will receive; only that in most cases general recognition of the superiority in quality of work is more difficult to obtain: there is commonly a difference between the real value of a superior labourer to his actual employer, and his market value as estimated by employers generally, which difference is the natural remuneration of the superior insight of the employer who secures the superior employee.

In the first instance, however, we will confine our attention to the case of the worker of average ability and industry, who cannot reasonably expect more than the average rate of wages in his department of work. It may be thought perhaps that what such an average worker may reasonably expect, under a system of free competition, may be stated still more generally as the average net advantages¹ obtained by average labourers generally within the region over which the competition is effective:—that, in the words of Adam Smith, “the whole of the advantages and disadvantages of the different employments of labour and stock must in the same neighbourhood be either perfectly equal or continually tending to equality...at least in a society where things were left to follow their natural course.” For “if in the same neighbourhood there was any employment evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of other employments.”

And, in fact, in Adam Smith’s careful analysis of inequalities of wages “arising from the nature of the employments themselves,” independently of “the policy of Europe,” there is no express recognition of any differences inconsistent with this general statement². Nor can it reasonably be doubted that

¹ I use this term—taken from the *Economics of Industry*—to denote what Adam Smith calls “the whole of the advantages and disadvantages” of the different employments of labour: which is a somewhat loose phrase to express the ‘balance of advantages after compensating for extra disadvantages.’

² When, however, we look at the details of this analysis, we observe that Adam Smith does distinguish one case in which this tendency to equality clearly does not operate: that is, where “trust” is required. As Mill justly remarks,

industrial competition has, within certain limits, the equalizing tendency attributed to it by Adam Smith; or that in the absence of the counteracting forces of Custom and Combination, this tendency would be more strikingly manifested than it has yet been in any European community. But the further discussion which Mill and others have given to this point has brought into view important inequalities in the real reward of certain kinds of labour, which are in no respect compensatory for inequalities in the sacrifices entailed, and which yet the development of competition has no necessary tendency to remove, except in a very indirect and remote way.

The importance of this consideration we have already had occasion to notice¹. But as the nature and conditions of these inequalities have hardly obtained sufficient recognition from the followers of Adam Smith generally, I propose to devote fuller attention to them in this chapter: confining myself for the present to the causes which would still operate, even under a system of complete "natural liberty," provided that the existing inequality in the distribution among human beings of wealth, and of marketable natural qualities, moral and intellectual, were not materially changed by some cause other than free competition.

First, however, it is to be observed that what industrial competition directly tends to equalize is not the price of equal quantities of labour, but the remuneration of labourers of equal skill and energy. Hence it may have no visible effect on the price of a particular kind of labour, if all the labour of this kind required to satisfy the demand of society can be sufficiently supplied from the spare time of energetic persons regularly employed in some other way. Secondly, we may note that, in the passage above quoted from Adam Smith, this equalizing tendency is only supposed to take effect, so far as the advantages and drawbacks of different employments are (1) "evident" and (2) "within the same neighbourhood." We have already had² occasion to take account of the first

the superiority of reward in this case is not in any way compensatory for special sacrifices: trustworthiness has an extra value due to what I call "scarcity," and Mill "natural monopoly."

¹ Cf. *ante c.* II. § 8 of this book.

² *c.* II. § 8 of this book.

limitation in discussing tendency to equality of profits in different industries: and in any application to concrete cases of abstract reasonings based on the assumption of industrial competition it is fundamentally important to bear in mind that inequalities of remuneration only tend to be removed so far as they are "evident" to the class of persons detrimentally affected by them. Such 'evidence' is more likely to exist where the unequally remunerated employments are "in the same neighbourhood": but a large amount of knowledge about the wages of labour in remote places is now everywhere attainable in civilised communities; and is actually attained to a considerable extent, which, however, varies a good deal according to the different intellectual development of the classes affected. So far as this knowledge exists, industrial competition will tend to remove any appreciable differences in the real remuneration of labour of the same quantity and quality¹ in different localities, that are more than sufficient to compensate for the expense and other losses and sacrifices involved in migration from one locality to another—supposing that the expense is not actually beyond the means of the persons affected. The obstacles presented by such expense and sacrifices vary indefinitely at different times and between different places; but we may say generally that the range within which their effect is comparatively slight tends to become continually larger as civilisation progresses.

Thirdly, however, it must be borne in mind that, even within such a limited range, the equalizing tendency of Industrial Competition can only take effect gradually; and, to a great extent, through the influence exercised by changes in wages on *prospective* rather than on *present* labourers. At any given time and place the price of the services rendered by labourers depends on the relation of the supply to the demand no less than the price of any material product of labour. There is thus no

¹ In comparing qualities of labour it should be borne in mind that the processes of (nominally) the same industry are somewhat different in different places; so that labourers cannot migrate between such places without a certain loss of acquired skill. Again, if the labourers in any district have a low average standard of physical efficiency in consequence of their low wages; then, however easy migration may be to a neighbouring district where both the wages and the efficiency are greater, the difficulty an immigrant would have in earning the higher wages would be a serious obstacle to equalization.

reason, so far as industrial competition goes, why a sudden fall in the demand for any particular kind of skilled labour should not reduce its remuneration to the level of that of altogether unskilled labour: or even below the average of this latter so far as the skilled labourer's previous habits of work have unfitted him for unskilled labour. Nor, indeed, is there any economic reason why an extensive change in processes, or local displacement, of any particular industry might not reduce the remuneration of any kind of labour in a particular district even below the point sufficient to furnish the labourers with necessaries of life; unless an outlet for the labour thus rendered redundant were adequately and promptly supplied by emigration¹.

§ 2. Let us now proceed to explain and classify the inequalities in particular wages, which industrial competition does not directly tend to remove, even within the limited range and in the gradual manner just described.

First we may place such differences as are apparent rather than real: such as the higher rate of wages in some employments, due to "inconstancy of employment" and "uncertainty of success." In this case even the average money wages of average workmen during long periods may not be higher in such employments than they are in others with which we compare them; and it is, of course, only such an average that competition tends to equalize. In other cases an inequality in money wages merely balances some opposite inequality in advantages not purchased by money, or compensates some extra sacrifice. For it must be borne in mind that the "real reward" or "net advantages" obtainable by labour, which industrial competition tends to equalize, have to be taken to include not merely commodities actually unpurchased—such as the free grazing and free cottage-site that an English agricultural labourer often enjoyed a century ago—but all appreciable utilities whatever, whether generally purchasable or not, which any particular kind of work affords special opportunities for obtaining. Thus, for instance,—as Adam Smith notices—the fact that any calling stands higher in social repute than another, will tend *ceteris paribus* to attach to it a lower average income. Similarly we

¹ Some further discussion of these local and temporary variations in wages and their causes will be found in a subsequent chapter (ch. xi.).

must include on the negative side of the account not only sacrifices that indirectly involve pecuniary loss—as when a certain kind of work tends from its unhealthiness to shorten the average working period of life—but all drawbacks and sacrifices whatever. It should be observed, however, that there is no tendency to compensate special disadvantages felt by particular labourers owing to special social circumstances or physical constitution, if equally competent labourers who do not feel these disadvantages could be readily obtained in their stead. Nor, again are the sacrifices, which thus tend to be compensated, exactly the average sacrifices made by the whole body of labourers in any given employment; but rather the average sacrifices made by that section of the body in which the strongest aversion is felt to the employment, provided that they are not compensated by any advantages similarly peculiar to such persons, and that society finds it worth while to buy their services at the price required to overcome this aversion. It would be quite possible that some members of the class might have no dislike at all to their work,—or might even derive much positive pleasure from it; still, their self-interest would prompt them to demand the highest price obtainable for their services; and competition would enable them to obtain as much remuneration as was found necessary to compensate the sacrifices of their fellows. Similarly the special advantages attaching to any kind of work have no tendency to lower the wages paid for it, if they are only felt to be advantages by a number of persons so limited as to be unable to supply more than a fraction of the whole labour that society is willing to purchase at the higher rate which, independently of these advantages, it would tend to command.

Secondly, no exception is constituted to the general rate of equality of net advantages in different employments by any differences in wages, which merely compensate for differences in the cost of time and money, entailed by the previous training which skilled labour requires. If wealth were equally distributed and competition perfectly free, this cause would still operate to raise the net advantages earned by a given amount of skilled work above those of an equal amount of unskilled work: though the general correspondence of remuneration to

sacrifice would still be maintained. Under such circumstances, supposing the rate of interest given, we could determine exactly the normal differences of wages due to this cause in any given case: it would be sufficient, if continued for the average working period of life of such a skilled worker, to replace with interest the wealth expended in teaching the worker and maintaining him during the extra years of his education—subtracting, of course, whatever was earned by the pupil before his education was completed. In short the sum so expended would tend to yield, precisely in the same way and to the same extent as any other capital, a return proportioned to the amount and the period of investment. And there can be no doubt that a considerable part of the higher wages of skilled artisans and professional men in England is actually to be referred to this cause; and to be regarded as a replacement with interest of the “personal capital” which they possess in their expensively acquired skill.

But *thirdly*, in a society in which wealth is distributed as unequally as it is in our own, it is likely—quite apart from any influence of combination or governmental interference—that certain kinds of skilled labour will normally be purchased at an extra price considerably above that required to replace, with interest at the ordinary rate, the expense of acquiring the skill; through the scarcity of persons able and willing to spend the requisite amount of money in training their children and supporting them while they are being trained.

In explaining how precisely this scarcity is maintained, we are met with a question to which political economists generally have given rather vague answers: viz. what general assumption may legitimately be made as to the limits of parents' willingness to sacrifice their own present comforts and satisfactions to the future well-being of their children. Probably it would correspond fairly to the facts as they exist in England at the present time if we assumed that average parents in all classes are willing to make considerable sacrifices in order to give their children the training required to enable them to remain in the same grade of society as the parents themselves: but not to make the greater sacrifices required to raise them above their own class. If so, it is easy to understand how the labour of any grade above the lowest should be maintained at a scarcity value.

But even if parents generally in the lower grades of labour were desirous of doing their utmost to give their children a better education, it might easily be out of their power to do this—consistently with the maintenance of their own industrial efficiency and the health of their families—except by borrowing; from which resource they would ordinarily be cut off by their inability to give adequate security for repayment. For the parent, even if he had confidence that his child would be able and willing to repay out of his future wages the capital borrowed, is rarely likely to find a lender who will share this confidence.

In this way we are led to the conclusion that inequalities in the distribution of produce so considerable as those which exist in our own society have a certain tendency to maintain themselves which is quite independent of the mere *vis inertiae* of custom. Such a society is likely to organize itself in grades or strata distinguished by differences of income; and so far separated that—though individuals are continually ascending and descending—the transition is yet not sufficiently easy to prevent the labour of any superior grade from being kept at a scarcity value. That this is largely the case in England at the present time will appear *prima facie* from a cursory comparison of the actual differences between the wages of unskilled labourers and those of different classes of skilled labourers, with the interest on the additional outlay ordinarily required in training a child to become a member of any of these latter classes¹.

These higher rates will of course be liable to continual

¹ The statement in the text may appear paradoxical to many readers, who are accustomed to hear that all the professions are over-crowded. But the explanation of this current report is that custom, supported by open or tacit combination, keeps up the price of professional services so high that a professional man—barrister or physician—whose time is fully employed, obtains an income considerably above the average. Competition—as we shall presently notice—under these circumstances, so far as it operates, brings down the average remuneration of the members of the profession by increasing the number of the unemployed and partially employed. I conceive that, though precise statistics are unattainable, it can hardly be doubted that the average income earned by persons of ordinary skill in any of the learned professions in England exceeds the average income of an unskilled labourer by a sum materially greater than interest at the ordinary rate on the capital necessarily expended on the education of the professional man, and his support during the years in which he is being educated.

fluctuations from changes in the relation of the supply of the labour of each grade to the field of employment for it; and it should be observed that the limitation of supply necessary to maintain the higher wages of any grade requires generally speaking an effective restriction on the natural increase of population within the grade, as well as an effective barrier against intrusion from below. But such a restriction tends to result, in a general way—as we have had occasion to note—from the habitual standards of comfort prevalent in the respective grades; though, as was pointed out, the resistance offered by any such habitual standard to changes in wages is by no means rigid.

It has further to be observed that many classes of skilled workers not ordinarily regarded as capitalists use more or less expensive instruments and materials; which adds, of course, to the total amount of capital which their labour requires¹. A further quantum of capital, in a different shape, is employed by artisans of the classes of shoemakers, tailors, the species of carpenters called cabinet-makers, and others, so far as they produce goods for sale on their own account. Such persons are in fact small traders as well as manufacturers; and their earnings, like those of other small traders, partake of the nature of profits in a varying degree, proportioned to the amount of capital that they use.

It is not improbable that the average profits made by such artisan shopkeepers, or by retail traders generally, may be sufficient after paying ordinary interest on the capital employed, to afford an extra rate² of remuneration for the services of

¹ I may remind the reader that the line between outlay for production and outlay for consumption cannot always be sharply drawn; and that in some cases a portion of the expenditure ordinarily paid out of income must be partly reckoned under the former head—e.g. the expense of a physician's carriage, or a literary man's books. In other cases, again, instruments which would ordinarily be reckoned as producers' capital are partly also used unproductively—e.g. farmers' horses.

² I avoid speaking of this as a scarcity rate, since it might be somewhat misleading to suggest that any extra remuneration of retail traders, as compared with labourers not possessed of capital, should be referred to the 'scarcity' of such traders—although in a certain sense it would be true. For—as I shall have occasion to urge hereafter, when considering the deficiencies of *laissez faire* as a means to the most economic production,—industrial competition, in such a case

these classes, as compared with the lower grade of skilled labourers who work for hire. But it is not easy to say how far this is actually the case, at any particular time and place. For, as I have before observed, the average returns to employers of capital in any branch of industry are much harder to ascertain even approximately than the average remuneration of any class of hired labourers. Numbers of small tradesmen are continually passing through the bankruptcy court; others, again, are continually extending their business and becoming large tradesmen; while the majority appear to struggle on with considerable fluctuations of income, avoiding complete failure but not adding importantly to their capital. We have no such statistics as would enable us to estimate the average earnings of this class of workers. Even if we had them it would still be doubtful whether an average obtained by dividing the total amount of profits earned by the number of persons employed in retail trade would give us approximately the remuneration which an ordinary trader might reasonably expect. For such an average would be raised by the large gains of the successful minority: and these large gains are probably in most cases due to the possession by the successful trader of special aptitudes for his business. The skill required in retail trade is partly, no doubt, of a kind that an ordinary man can acquire by a certain definite outlay of time and instruction; so far as it consists of the arts of reading, writing, book-keeping and adequate knowledge of the qualities of the articles traded in. But for success in trade it would seem that qualities are required which instruction cannot ordinarily give in the required degree, such as penetration, vigilance, quickness of resource in meeting emergencies; by which the trader is able to seize the opportunities great and small, and avoid the dangers of loss, which the changing conditions of supply and demand are continually bringing in the modern industrial world. Hence the earnings of traders adequately gifted with these qualities will tend to be kept

as this, has no sufficient tendency to reduce the number of competitors down to the limits that economy requires; its effect is too often merely to divide the aggregate employment and earnings of the class among a larger number of individuals.

high by the rarity of their talents relatively to the field of employment for them.

We are thus led to notice the only remaining important cause of inequalities in the remuneration of different kinds of labour—the scarcity of the natural gifts required for the most effective performance of their function. I have already pointed out that in almost every branch of industry to some extent—but to very different extent in different branches—wages above the average can be earned by labour of superior quality; such superiorities, speaking generally, being partly due to training and partly to the possession of natural and inherited aptitudes above the average. Where such superiority is exhibited in producing more easily and abundantly commodities of the same quality as inferior workers can supply, the extra remuneration obtainable by it is in a manner analogous to the high rent of fertile land used for ordinary agricultural purposes; since, as we have seen, the superior productiveness of land from which rent arises, is due partly to outlay and partly to natural differences independent of labour¹. On the other hand, where the commodity produced by rare skill is valuable on account of its special qualities, real or supposed, the reward of such skill may be compared to the high rents obtained by the owners of famous vineyards and other portions of land of which the produce is peculiar and keenly desired: while again, so far as the services of any one individual have—or are believed to have—unique qualities, his remuneration is, of course, determined under the conditions of strict monopoly. Both these latter cases are exemplified by the rewards of the finer kinds of intellectual work, such as Literature, Painting, Mechanical invention: where the results which command substantial remuneration, cannot be obtained by education alone, without natural gifts so exceptional that the reward of their possessors is but partially affected by competition. To a less extent the same cause is operative in determining the distri-

¹ Even in employments where the differences in skill and its remuneration are less marked, it is still to be observed that the outlay on education, &c. which constitutes Personal Capital, yields a profit varying importantly in amount in consequence of the different intellectual and moral qualities of the children educated.

bution of the large incomes which constitute what are called the "prizes" of the professions of Advocate and Physician. The workers who earn these large incomes are believed by those who use their services to possess such exceptional skill as cannot be acquired by mere training and practice without rare¹ natural gifts.

Even when the skill required is not sufficiently exceptional in fact to command a scarcity value, the difficulty that people in general have in ascertaining the fact of its existence often secures a scarcity rate of remuneration to the professional men who have special means of obtaining good recommendations; such as kinship or friendship with persons who enjoy public confidence, &c.

This leads me to notice another cause of a different kind which renders the incomes of individual traders and professional men larger than they would otherwise be; and which, like the scarcity of natural qualities just discussed, ought to be specially noted and partly discounted in estimating the average remuneration of the classes to which they belong. I mean the important economic fact that we have already more than once noted², under the names of Goodwill or Connexion: i.e. the widespread disposition to use the services of a particular individual rather than his competitors, not necessarily on account of any belief in their superior quality, nor even through kinship or personal acquaintance with the individual himself or his friends, but merely from the force of habit. We have already seen that this Goodwill is to a certain extent a saleable commodity; so far then as it has been purchased, the extra remuneration obtained by it is, from the point of view of the individual, interest on capital laid out. It is evident that in estimating the average return for labour in any employment in which earnings are largely increased by such Goodwill or Connexion

¹ It should be observed that when we speak of 'rare' skill, the term is always used relatively to the demand for the products or services of the skilled worker. It is quite possible that a given kind of skill may be confined to an extremely small minority of the members of any community, and yet may be so abundant relatively to the demand that no one possessing it is able to earn extra remuneration for his labour. This is the case (e.g.) with the faculty of writing second-rate poems.

² Cf. *ante*, Book I. c. III.

we ought not to reckon the whole of the extra earnings due to this cause, but only the amount that an average man with proper training and industry may fairly expect to acquire for himself.

§ 3. We have now come to the point at which it is desirable to concentrate our attention on that important portion of the produce of industry which is frequently but erroneously included in the "capitalists'" share: that is, the element of the profit made by the employers of capital which is in excess of the interest that they might have obtained without working, and which accordingly I have distinguished as Wages of Management. It is an important defect of English Political Economy that it has not, for the most part, conceived this element of the employers' gains with sufficient steadiness and clearness as a species of remuneration of labour—which it undoubtedly is. Even Mill's exposition—in spite of his careful analysis of profit into interest, risk, and "wages of super-intendence,"—exhibits in important parts of the argument a want of distinction between profit and interest, and a tendency to identify "returns to capital" with the former instead of the latter, which seem to me highly confusing¹. If we consider the large amounts of capital possessed by joint-stock companies, as well as all that is lent to private men of business, it must be evident that the greatest part of the capital of England is now really owned by persons other than those who receive the remuneration for managing it. When Ricardo and M^cCulloch wrote this was far less the case than it is at present; so that the identification of capitalists and employers was more naturally suggested by the facts of industry.

It is, I think, partly in consequence of this confusion that so many political economists have found no difficulty in assuming that the rate of profit²—allowing for difference of sacrifice and risk³ in different employments—tends, on the average, to be

¹ My attention was first drawn to this point by Prof. F. A. Walker's excellent book on "Wages."

² It may be worth while to point out, with Mr Macleod, that throughout this discussion, 'rate of profit' must be understood to mean 'rate of profit earned within a given period of time,' not 'rate of profit earned on each transaction.'

³ When we are considering what average profits generally tend to amount to, the element of 'indemnity for risk' disappears.

simply proportioned to the amount of capital on which it is earned, just as the rate of interest does; without feeling called upon to explain how the employers' "wages of superintendence" come to vary precisely in the same ratio as the capital superintended. For, as I have briefly argued in a previous chapter¹, this latter result certainly does not follow as an immediate and obvious deduction from the hypothesis of unrestricted industrial competition. On the other hand, it does follow from that hypothesis, that if this proportion between employers' earnings and capital is really maintained, it must either be (1) because the trouble and anxiety of management increase in exact proportion to the amount of capital managed; or (2) because, in the competition of employers for the profits of business, the owners of large capitals are somehow able to obtain from society remuneration for their services on a higher scale than that of smaller capitalists. The former of these causes can hardly be regarded as adequate to produce the effect. In trade, for instance, it seems no more trouble to order £2000 worth of sugar than to order £1000 worth; and though it is more troublesome to manage a large factory than one half the size, it can hardly be twice as troublesome. It may be said, however, that the personal sacrifice which a capitalist makes in enduring the labour and worry of business increases with the size of his capital, and the extent of the opportunities consequently open to him of enjoying life without working. And this is perhaps true, so far as we estimate sacrifice merely relatively to the individual who makes it: no doubt a certain number of large capitalists prefer to live on interest alone rather than increase their income by labour, and we may assume that a somewhat larger number would make this choice, if the additional income obtainable by labour were materially reduced. But this is not in itself a sufficient reason why free competition should provide large capitalists with the extra wages of management necessary to induce them to work; since, as we before noted, the competitive remuneration of any kind of labour does not tend to include compensation for the extra aversion felt to it by some of the labourers, except so far as such compensation is required to obtain the whole amount of the labour in question

¹ C. II. of this Book.

that society is willing to buy, even at the raised price. If large capitalists withdrew from business, because their average wages of management were insufficient to induce them to work, they must still leave their capital to be employed in some way, in order to get their interest; and though their withdrawal might, by increasing the supply of capital offered for loan or joint-stock investment, temporarily lower interest and therefore increase wages of management, there seems no reason why this latter rise should be permanent, supposing that an adequate supply of equally good managers is obtainable at the lower rate of remuneration which the discontented capitalists were getting. Hence if the strict proportion of employers' earnings to capital employed is, on the average, approximately realised, it must be on the second of the grounds above mentioned: the large capitalist who enters into business must be somehow able to sell his services to industry at a price graduated in proportion to the magnitude of his business. Let us examine how far, and in what way, this is likely to be the case.

In the first place, it is obvious that the employer's wages of management will be proportioned to his capital so far as the pecuniary cost of production to the employer, in any branch of industry, does not vary materially with the scale of production: since, under free competition, the market-price of the product must be the same—assuming that there is no difference of quality—however it may have been produced. We cannot however assume generally that cost of production is approximately the same for small and large employers alike; each class, as we have seen, has certain special advantages as compared with the other, between which a balance has to be struck, varying according to the nature of the industry. For instance in certain kinds of agriculture, where much is gained by minute and vigilant tendance, the small producer is thought to have a decided advantage: in other industries, again, the balance of advantage would seem to incline the other way, the large production being on the whole more economical; so that in these latter cases the remuneration of the employer would normally increase in even a greater ratio than the capital employed. Now it is manifest that, under a system of free competition, where production on a small scale is the more economical, the

small employer ought to be able to keep his rate of profit (per cent. of capital) above the rate current in other industries, by keeping up the price of his commodity. Thus if retail trade is more effectively carried on in small shops, the retail trader will tend to receive a proportionally larger annual profit on his capital than the wholesale trader—independently of any additional profit on each transaction, that may be necessary to compensate for the less rapid turn-over. And it may be urged that self-interest will in the long run prevent business from being conducted on a small scale, except when it is economically advantageous; that the small capitalist will either (1) become a large employer by borrowing money, or will (2) unite his capital with that of other small owners, and become a shareholder in a joint-stock company.

The first of these expedients, however, can only be adopted to a limited extent. The owner of a small capital cannot ordinarily borrow beyond a small amount, except at an unremunerative rate; his whole capital being exposed to the risks of business, he cannot give adequate security to the lender. Hence the owners of large capitals are partially exempt from competition in the management of private businesses on a large scale; from causes similar to those which, as we have just seen, partially exempt each of the different grades of labour from the competition of the grade below. It is true this exemption from competition can only be partial, in a society with an abundant supply of capital continually available, and an active competition for customers on the part of banks and other lenders. In such societies, as Prof. Walker says, if a small capitalist has a "genius for business, want of capital is not likely to keep him under." A man who as manager for another, or as employer on a small scale, has given conspicuous evidence of skill, prudence and probity, will be able to borrow gradually increasing amounts of money; so that, by the augmentation of both his own and his borrowed capital, he may end by rivalling the largest producers. But such men are likely to be rare, no less than persons who start with large capitals; so that either class is likely to be able to obtain a scarcity price for its services, so long as industry is organised in private businesses.

It remains to ask why this scarcity value is not reduced by

the association of small capitals into joint-stocks, for carrying on production on a large scale. In the first place, even supposing the rate of profit to be strictly proportioned to the capital employed, it is quite possible that the wages of management even of the comparatively small capitalist may be higher than the remuneration he would obtain for his labour in any other career; and that consequently there may not be a sufficient amount of capital owned by non-employers to offer, when aggregated into joint-stocks, a formidable competition to the large private employers. Where this is not the case, where, as in our own society at the present day the annual savings of professional men, &c., supply continually a large stream of capital that has to be managed by persons who do not own it; there can, I think, be no doubt that the competition of joint-stock companies does tend somewhat to reduce the rate of profit of private employers. Still, this tendency is strictly limited. For, firstly, assuming the two modes of management to be equally effective and economical, the private capitalist would still have an advantage, as he would avoid the trouble and expense generally involved in collecting the capital of a joint-stock company. And secondly—what is more important—the private employer has the economic advantage of being impelled by a stronger stimulus to exertion than the manager or directors of a company; for “no contrivance that has yet been invented can supply the place of “the feeling that the workman is labouring not for another but “for himself¹.” On these grounds, other things being the same, a man of sufficient business talents to obtain employment as the manager of a company, is likely to earn, on the average, a higher rate of remuneration if he is the owner of the capital he employs than if he is a hired manager; though his advantage varies very much with the nature of the business, being (as Adam Smith observed) less in proportion as a business is simple and can be reduced to “what is called a routine.”

Nor has it yet been shown that this advantage can be materially diminished through the adoption of the principle of “Co-operative Production” or Industrial Partnership, by which each employee in a business has a share of the profits allotted to him. It is true that by this means that part of the em-

¹ Hearn's *Plutology*, c. xiii. § 9.

ployer's function which consists in superintendence or overlooking, may be partly rendered superfluous through the pecuniary concern that each has in the efficiency of his own work, and still more through the concern that all have in the efficiency of the work of each. But, generally speaking, the more important part of the work of management consists in organising and directing the operations of a business considered as a whole:—e.g. in the case of a manufacturer, settling what is to be made and in what manner, where materials, raw and auxiliary are to be bought, when finished products are to be sold, &c., &c.—and in distributing functions among the workers employed in the business. This work cannot be superseded or reduced by industrial partnership; and it is even liable to be made more difficult; since the secrecy necessary to the success of many operations of business is liable to arouse jealousies and suspicions among the workers who are to share the profits¹.

It seems, therefore, that industrial competition does not necessarily tend to prevent the services of large capitalists who engage in business from being remunerated at a rate considerably higher than that obtainable by similar labour on the part of employers who own smaller capitals. And that this result is actually produced in England and similar countries at the present time, may be inferred with tolerable certainty from the general unquestioning acceptance of the traditional economic doctrine, that employers' earnings, as well as interest, tend to be proportioned to amount of capital employed. There does not, however, seem to be any adequate ground for regarding this generally accepted proposition as at all a close approximation to actual fact. It is, no doubt, a natural inference from the fact that large and small businesses exist prosperously side by side, so far as the respective economic advantages of the different scales of production may be assumed to be evenly balanced. But even in cases where this assumption is legitimate, the inference that the rate of profit *per cent.* of capital is uniform overlooks, I conceive, the real nature of

¹ In the above remarks, I must not be understood to imply a judgment on the whole adverse to the efforts that are now being made to extend the application of the principle of 'Participation of Profits.' I shall have occasion, in the course of the following Book, to show the importance that I attach to these efforts.

the source of income which I have several times spoken of as 'Business Connexion.' On the average, a large capitalist cannot obtain a large business by merely investing his money in certain kinds of real capital; he can only obtain it gradually as his connexion extends; and therefore, when obtained, a certain portion of the surplus income derived from his business, after subtracting interest on his material capital, is not properly remuneration for present work, but interest on the outlay of labour or wealth made during the earlier years of the business. And secondly there are certain important cases in which the received economic theory, confirmed by experience, regards an employer as tending under competition to obtain 'ordinary profit' not on the whole amount of capital used by him, but only on a certain portion. In agriculture, for instance, the farmer uses, besides his own capital, a certain amount of capital belonging to his landlord: yet he is never supposed to obtain any considerable wages of management for this latter, but only to get ordinary profit on his own or borrowed capital. And it may be assumed that a farmer owning the land farmed—granting that the 'magic of property' might make him earn somewhat more—would not become so much more efficient a labourer as to earn 'ordinary profits' on the whole of his capital. But if this be admitted, I see no adequate reason for drawing so broad a distinction between agriculture and other kinds of business as to assume generally that an employer tends to earn ordinary profit on all parts of the capital employed by him. It seems indeed highly improbable that this is the case wherever the trouble of managing different parts of the capital is materially different¹.

¹ The difficulty involved in the common assumption that the employer tends to earn the same profit on every portion of his capital, may be illustrated by a passage in Cairnes' *Logical Method of Political Economy* (ch. 8), in which the writer is arguing in favour of the Ricardian theory of rent. He says that "in order to induce the cultivation of inferior lands and the forcing of superior lands up to such a point as shall secure to the community the quantity of food required for its consumption, the price of agricultural produce must rise at least sufficiently high to indemnify with the usual profits the farmer for this—the least productive—portion of his outlay. If the price were not sufficient for this, the farmer would withdraw his capital from the production of that portion of his crop which is raised at greatest expense, and would invest it in some other business in which he had a fair prospect of average profits." But it must be obvious that, generally speaking, a farmer could

To sum up: a portion of the fund which, in the preceding chapter, we regarded as the share of labour, in the aggregate has been found, on closer examination, to be really interest on personal capital, by which the wages of various kinds of skilled labour tend to be increased by an amount proportioned, on the average, to the expense of time and money ordinarily needed for the acquisition of the skill. As regards the division of the remainder, industrial competition tends to equalize the shares obtained by ordinary labourers in different callings, provided they are not materially unequal either in natural qualifications or in respect of the amounts of capital possessed by themselves or their parents, except so far as differences in wages are compensatory for differences in the sacrifices entailed by different employments, or in the unpurchased advantages incident to them. But the possessors of capital, real and personal, as well as persons endowed with rare natural gifts, are likely to have—by reason of their limited numbers—important advantages in the competition that determines relative wages; in consequence of which the remuneration of such persons may—and in England actually does—exceed the wages of ordinary labour by an amount considerably larger than is required to compensate them for additional outlay or other sacrifices; such excess tending to increase as the amount of capital owned by any individual increases, but in a ratio not precisely determinable by general considerations.

only obtain ordinary *interest*, not employer's *profit*, on capital invested elsewhere than in his business: and in considering whether it is worth his while to invest an additional portion of capital in his business, the question which enlightened self-interest will suggest is not, surely, whether he will obtain "the usual profits" on this portion of capital, but whether he will obtain enough beyond ordinary interest to compensate him for his extra trouble of management. And similarly in other businesses besides agriculture it may easily happen that the only opportunity for extending production as presented to an employer is such as may reasonably be expected to yield more than ordinary interest, yet not so much as ordinary profit; while at the same time the excess above ordinary interest is quite sufficient to compensate for his extra trouble.

CHAPTER X.

MONOPOLY AND COMBINATION.

§ I. THE effects of Combination in increasing profits and wages have attracted much attention in recent years, owing partly to the action of Trades-Unions, partly to the large gains made by successful combinations of merchants for the temporary monopoly of some indispensable or keenly demanded product. Such combinations, when manifest and manifestly profitable, have commonly excited dislike, as the gain accruing from them is *primâ facie* obtained at the expense of the rest of the community, and frequently with some loss to the community as a whole: and in the particular case of Trades-Unions, some writers have spoken of them as “interferences with the laws of Political “Economy.” But if this phrase is intended to denote the laws investigated by Economic Science, the statement appears manifestly incorrect, even according to the view of economic method generally accepted in England. The price of a monopolized article has its own economic laws, and can be theoretically determined on the hypothesis that every individual concerned intelligently seeks his private pecuniary interest, no less than the price of an article sold by competing dealers: and the only effect¹ of a Trade-Union or any other Combination is to bring the supply of the commodity of which the sellers combine under the conditions of a more or less perfect monopoly.

Hence—though I have followed usage in conceiving free competition to exclude combination—it seems desirable, in working out the consequences of the general assumptions on

¹ Provided, of course, that the combiners attain their end by purely peaceful and legal means.

which the theory of competitive distribution proceeds, to include an investigation of the conditions under which self-interest will prompt to combination, and of the extent of gain which the persons combining may realise.

In a preceding chapter I have briefly explained the general laws of monopolized supply, in the case of material products. The monopolist, so far as he aims singly at his own pecuniary interest, will endeavour to sell the precise amount which will yield him the maximum net profit, after defraying the expenses of production. We may assume generally, that, in order that a monopoly may be a source of gain, the amount sold must be somewhat less than it would be if there were no monopoly¹; for otherwise, whatever extra profit the monopolist may make by the high price of his commodity cannot be strictly attributed to the monopoly, since the price would have tended to be the same if the supply had been in the hands of a number of sellers competing freely. The restriction in amount sold may be brought about either directly by limiting the amount brought to market, or indirectly by keeping up the price. In the latter case the restriction may not be intended by the monopolist, and he may possibly be even ignorant of its existence; but according to our general assumption as to the relation of Value to Demand, the maintenance of a high price of any commodity must *ceteris paribus* render the amount sold less than it would have been if the price had been allowed to fall; though in the case of necessaries of life, and other commodities of which the demand is inelastic, the reduction in sale may sometimes be comparatively slight, even for a considerable rise in price. The extent to which the restriction of sale has to be carried, in order to realise the maximum profit attainable, depends primarily on the precise nature of the law of demand for the commodity; and, as was pointed out, it may easily happen, in the case of some articles, that several different amounts of supply would bring in about the same net profit

¹ That is, if the price offered for the commodity is not influenced by open or tacit combination among the purchasers. As will hereafter be stated, the determination of price resulting from a struggle between a combination of sellers and a combination of purchasers, lies beyond the scope of the theory here expounded.

to the monopolist. We further noticed certain variations in the conditions of monopoly: as (1) that it may either be permanent (so far as can be foreseen), or more or less definitely limited in time; and (2) that the supply may either be absolutely incapable of being increased—as in the case of pictures of a deceased artist—or the monopolist may control the indispensable means of increasing it. In this latter case he will have to calculate not only the variations of demand corresponding to variations of price, but also the variations of cost of production corresponding to variations in the amount supplied.

Similar considerations—*mutatis mutandis*—may be applied to the case of monopoly of particular kinds of labour. We have already observed that in the highest grades of skilled labour, the repute of exceptional skill frequently confers such a monopoly: and, as has been said, no fundamental difference is introduced into the theoretical determination of monopoly values, by the fact that the monopoly results from a combination of several individuals, seeking each his own pecuniary advantage. At the same time, the great practical importance of combinations to raise wages renders it desirable to pay special attention to the extent of their possible success and the conditions of realising it. Accordingly, in the present chapter, I shall be especially concerned to trace out the economic effects of this kind of combination, regarding it merely as one mode of constituting monopoly: and I shall suppose here, as in the preceding chapters, that neither party in any exchange is restrained in the pursuit of its own interests by any regard to the interests of the other party. I do not here consider how far this supposition has been actually realised in the operations of Trades-Unions for the purpose of raising or keeping up wages, or in those of the counter-combinations of employers which have at various times and places kept down wages. Nor, again, do I consider here how far it represents a right principle of conduct, or one conducive to the economic wellbeing of the community. This latter is a question to which our attention will be drawn in the course of the next book.

§ 2. But before we proceed to discuss this particular species of combination, it will be desirable to obtain a fuller definition of the notion of Monopoly—as we shall find it convenient to use

it—and a more complete view of the different modes and degrees in which monopoly generally, and especially monopoly resulting from combination, admits of being realised¹.

‘Monopoly,’ if we adhere strictly to the derivation of the word, should denote the control exercised by an individual seller or combination of sellers, over a commodity that no one else can bring to market. But, in the first place, it is convenient to extend the term to cases in which a person or union of persons—whom, for brevity, I will call ‘the monopolist’—cannot control more than a portion of the whole supply of the commodity; since such a partial control may render possible and profitable an artificial rise in the price of the commodity, even though the remainder is supplied by several sellers freely competing; if only the proportion controlled is so large that its withdrawal would cause a serious scarcity, and thus considerably raise the competitively determined value of the uncontrolled remainder. Such a partial monopoly confers, of course, only a limited power of raising the price of the commodity controlled; the limit of possible elevation being fixed somewhere below the price to

¹ Throughout the discussion that follows I shall assume that the special gains of the monopolist or of the combination of sellers are realised by raising the price of the commodity monopolized. I ought however to notice the fact that in the markets for securities combinations of sellers are sometimes formed which are designed to have, and actually do have, the opposite effect of lowering the price of the commodity sold.

The motive for forming such combinations is the hope of gaining ultimately by purchasing at the lowered price considerably more than is lost by the sales that force the price down. There would, however, be no reasonable prospect of realising this hope, except by accident, if such sales produced no further fall in price than that which resulted directly from the increase of supply by the combining speculators: since, *ceteris paribus*, their purchases would tend to raise the price again in precisely the same proportion as their sales had depressed it. The reason why such operations are profitable lies in the imitative proceedings of other persons holding the same securities, who infer from the sales that the stock is expected to fall further, and therefore are induced to sell their own stock, in order to avoid the further fall, instead of buying. A similar explanation applies, *mutatis mutandis*, to the parallel case in which combinations of buyers are successfully made with the view of raising prices.

Such operations are of doubtful legitimacy, even according to the ordinary standard of commercial morality: since the speculators do not merely expect to profit by the mistakes of others, but by mistakes that they have themselves intentionally caused. I have not therefore thought it necessary to give them more than this passing notice.

which scarcity would raise the unmonopolized supply, if the monopolized portion were withdrawn from the market¹. Further, if the commodity is one that can be produced in unlimited quantities, such a partial monopoly can only be effective temporarily, and only so far as purchasers of the commodity cannot postpone their purchases without serious loss or inconvenience. And where the monopolist *produces* as well as *sells* the commodity, he will have to take into account the future loss likely to result to him from the stimulus given by the rise in price to the production beyond his control; unless he can reckon on withdrawing his capital from the business without loss, before this stimulus has so much increased supply as to render it impossible for him to sell his own produce even at an ordinarily remunerative price.

Secondly, even where the control exercised by the monopolist extends over the whole supply of his commodity available at any particular time, we may still distinguish different degrees of completeness in the monopoly. Thus (1) the monopoly may be—so far as can be foreseen—indestructible, either permanently or for a certain determinate period: that is, it may be impossible to obtain the commodity in question at all, except from the monopolist. An artist or author of repute enjoys a monopoly of this degree; as also does the proprietor of a spring or vineyard of unique quality. Or (2) the monopoly may be merely secured by the prospective unprofitableness of the outlay of wealth or labour (or both) that would be required to provide the commodity from other sources; whether such outlay were undertaken by an association of the consumers of the monopolized commodity, or as an ordinary business venture on the part of other persons. In case (2) the monopolist's calculations will be more complicated than in case (1); since he will not only have to consider the law of the demand for his commodity, but also to calculate how far any rise in his charges may seriously increase the danger of an attempt to break down the monopoly. And it will often be prudent for him to keep his price well below the

¹ In the above reasoning it is assumed that the other sellers do not enter into the kind of tacit combination with the monopolist of which I shall speak presently. In practice they would, under certain circumstances, be very likely to do this to some extent.

point at which this danger becomes formidable, especially when he has much capital—personal or non-personal—invested in his business: since an attack on his monopoly, even when it does not turn out profitable to the undertakers, may easily have the effect of not only annihilating his extra gains, but even reducing the returns to his capital considerably below the average. This second degree of monopoly often results from the occupation of a limited department of industry, in which production on a large scale is necessary or highly expedient, by a single large firm or jointstock company, or a few such firms or companies acting in combination.

Thirdly, it will be convenient to extend the term ‘monopoly’ to include the case when it is in the power of a combination of *buyers*,—or a single wealthy buyer,—to control the price and extent of sale of a certain commodity. In speaking of this as a case of “buyers’ monopoly,” we are not, of course to be understood as implying that the whole medium of exchange in any community is under a single control. All that is required, to make such a monopoly practically complete, is that a single individual or combination may furnish the only effective demand for some particular commodity: i.e. that no one else may be willing to pay anything for it. Under these circumstances, if the commodity is supplied by several persons competing freely, the buyers’ monopoly may obviously exercise a control over the price substantially similar in kind and degree—though of course opposite in direction—to that exercised by a seller’s monopoly. If the purchaser has not to consider future needs, and if the product cannot be kept, or if the prospect of selling it is not likely to improve, the purchaser’s power of profitably reducing the price is not definitely limited except by the utility of the commodity to the seller—allowing for any disadvantage that may result to the latter in future transactions from the precedent of a low price. More ordinarily the purchaser’s need will be continuous or recurrent; and in this case his reduction of price will be checked by the danger of ultimate loss through the diminution of future supply which the lowered price may be expected to cause.

It should be said that, generally speaking, a combination of buyers will be more difficult to establish and maintain than

a combination of sellers, since the former are likely to be both more numerous and more dispersed. But there are important exceptions to this rule. For instance, the wholesale merchants who deal in a particular product will generally be less numerous than the producers from whom they buy. And it is probable that combinations of such dealers to keep down the prices paid by them have often been successfully effected, especially in early stages of commercial development. When, however, producers as well as merchants belong to a community commercially advanced, such a monopoly of merchant buyers will be rather hard to maintain long, owing to the ease and rapidity with which capital can be turned into any branch of wholesale dealing¹.

Another case of buyers' monopoly, specially important when we are considering the action of Trades-Unions, is that of a combination of employers to reduce (or keep low) the price of labour in any industry. Here again the limit which the employers' interest will fix to such operations will vary considerably according to the extent to which the labourers in question are active and intelligent in the pursuit of their own interests. If we assume industrial competition so perfect, that labourers change their residence and employment when it is perceptibly their interest to do so, the highest limit of the employers' possible gain through combination would tend to be fixed by the point at which the corresponding loss to the labourers would outweigh the disadvantages, pecuniary and sentimental, of migrating to some district beyond the reach of the combination, or the loss of acquired skill involved in change of work. And so far as the employers may be assumed to be interested in the future returns of their industry—as will practically be almost always the case—it will be dangerous for them to reduce wages to a point that would drive the rising generation to other employments, even if it did not affect their supply of labourers already trained. But in proportion as the habits of the labourers, or the limitations of their intelligence or of their resources, operate

¹ It may be observed that such a combination of dealers may exercise monopoly—in the extended sense above proposed—on two sides; i. e. in relation both to the producers from whom they purchase and to the persons to whom they sell.

as a bar to change of place or employment, the limit of the employers' possible gains through combination is obviously extended; since, supposing such change excluded, this limit would be fixed, so far as the present supply of labour alone is concerned, by the amount of necessaries required to keep the labourers in fair working condition¹; while so far as future supply is taken into account, it would similarly be fixed by the rate of real wages which will enable and induce the labourers to rear a sufficient supply of future labourers.

So far we have supposed that the monopoly, whether of sellers or of buyers, is not met by a counter-monopoly. Where this is the case, there is no economic formula for determining the rate at which exchange will take place, even on the assumption that either party is governed by a perfectly intelligent and calm regard to its own interests: provided, that is, that there is a considerable margin between the least favourable rates of exchange that it would be the interest of each side respectively to accept, if necessary, rather than not come to terms. Under these circumstances it is obviously the interest of both to divide this margin in any proportion, rather than not effect an exchange: but there are no general economic considerations that enable us to say what proportion would be chosen. Similarly we cannot say to what extent or for how long it is the interest of either side to suffer loss or inconvenience rather than accept the terms offered by the other party.

§ 3. The points that we have hitherto discussed are such as belong to monopoly generally, when considered from an abstract point of view; though in practice some of them are not likely to arise, except in the case of combinations. Let us now pass

¹ 'Fair working condition' is rather a vague phrase; but it is rather difficult to say how far an employer's self-interest will prompt him to add to his labourers' wages, when such additions, if properly spent, would increase the efficiency of the labourers themselves or of their children. If the employer could make sure that the extra wages would be properly spent, and that he would be able to purchase at his own price the improved labour, self-interest would obviously prompt him to give his labourers such wages as would make the excess of value of the results of their labour over what they consume (allowing for interest on the latter) as great as possible. But it will be only under special circumstances that he can feel even approximately sure on these points. Cf. ante, c. viii. § 1.

to consider some characteristics that are theoretically found only in this latter case.

In the first place, it is important to observe that a combination, however effectively it may restrict the supply of the commodity monopolized, will yet not be able to count on maintaining permanently the average earnings of the members of the combination perceptibly above the average earnings obtainable by persons of the same industrial grade in other employments imposing no greater sacrifices and requiring no scarcer qualifications, unless the number of the combining persons is also limited artificially. If entrance to the combination is left perfectly free, the only ultimate certain effect of limiting the supply of the monopolized commodity will be to alter the mode in which competition may be expected to reduce the earnings of the combining persons; instead of bringing down prices, competition will in this case merely tend to decrease the average amount of business or employment that the combining persons are able to obtain.

Secondly, we have to take note of the various ways in which the interests of the combiners in the aggregate may be related to the private interests of individuals among them. From the point of view of general theory, Combination presents itself primarily as a consequence of the unconstrained pursuit of private pecuniary interest by each individual who combines; but in dealing with actual facts we have also to consider cases in which a combination is imposed by social pressure upon individuals who find it onerous. Even in the former case—where each may expect to gain if all keep their compact to restrict supply—it may easily happen that the share of the gain of the monopoly accruing to any one member of the combination within a given period will be materially less than what he might obtain by increasing his own supply in violation of the compact; especially if such violation can be kept for some time secret. And the temptation to such breach will be still more strong if the members of the combination have to submit temporarily to positive loss in order to realize ultimately the gain aimed at; either because it is confronted by a counter-combination, which enters into a contest of endurance with it, or because its customers individually hold back, in the hope of making a better bargain

hereafter. In such cases it will be necessary for the combination to provide for the enforcement of its rules by substantial pecuniary penalties, or strong social sanctions; and, in some cases, it may be necessary to take precautions against secret evasion of rules, as well as against open violation. And such provision will, of course, have to be still more stringent, when the combination generally profitable to a given class of labourers has been only joined reluctantly by some individual members of the class; either (1) because they have special reason to dread the initial loss which the artificial restriction of supply will involve, or the sacrifices which a struggle between opposing combinations would entail; or (2) because the regulations necessary to ensure the carrying out of the combination—of which I shall speak presently—are specially unfavourable to them.

The consideration of social sanctions for the maintenance of a combined monopoly leads me to observe that besides the express combinations which we have hitherto had in view, in which resolutions are formally taken by a whole body of combining persons or by a council representing and obeyed by the whole body, similar results may be to some extent produced by more informal communications—or even without any communication, through the acquaintance that each member of the class has with the sentiments and habits of action of the rest. Such tacit combinations, indeed, are hardly likely to be effective for the attainment of a rise in the price of the commodity exchanged; except, perhaps, where such a general rise is obviously necessary to prevent a definite loss to the whole class, in consequence of some change of circumstances. But where the price of any product or service has acquired a certain stability through custom, the resistance which the mere *vis inertie* of custom would present to any economic forces operating to lower such price is likely to be considerably strengthened by the consciousness of each seller of the commodity that other sellers will recognise their common interest in maintaining the price, and that substantial social penalties are likely to be inflicted upon any one who undersells the rest. It is in this way, for instance, that the customary fees for professional services and the prices charged by retail traders, are sometimes

maintained above the rate to which a perfectly open competition would reduce them¹.

In order to see more fully the effects of this necessity of imposing sanctions for the maintenance of monopoly resulting from combination, let us examine more in detail the steps which the holder of a monopoly will have to take, in order to realize the maximum of possible gain. When the monopoly is complete, it obviously confers the power of fixing exactly both the amount and the price of the commodity supplied within any given time. But from the difficulty of forecasting the demand exactly, it can rarely be most profitable to do this—except for very short periods, determined by the custom of the trade and the convenience of purchasers. And such a course will generally be still less expedient, where the monopolist has not complete control of the market. Thus an individual monopolist who wishes to approximate as nearly as is practicable to the possible maximum of gain, will in most cases find it best to leave the actual total of his receipts to be determined within certain limits by the demand; either (1) fixing the price and letting the amount sold vary with the state of the market, or (2) fixing the amount to be sold and letting the price vary—so long as the variations are not very great. Which of the two courses he will adopt will depend a good deal on the nature of his business; which may be such as to render either frequent changes in amount supplied, or frequent changes in price, especially inconvenient. But *ceteris paribus* he will probably prefer to effect the limitation of his supply indirectly, by keeping up the price, so that the sacrifice of his customers' interests to his own may be less palpable and offensive. When, however, the monopoly results from combination, another consideration may sometimes determine the choice between the two alternatives; viz. the respective facilities that either affords for practically

¹ The actual extent of the operation of these unavowed, and more or less tacit, combinations is, from the nature of the case, very difficult to ascertain. Hence the mistake may easily be made of attributing to 'free competition' unfavourable effects on wages which are really due to combinations of this kind on the part of employers. And I am inclined to think that this mistake has sometimes been made by students of economic history, in dealing with states of society in which custom has ceased to determine wages, while yet manual labourers generally have not learnt to combine.

holding individual members of the combination to their compact. An agreement as to price would seem to be ordinarily both the simplest and the easiest to enforce. In some cases, however, though a direct reduction of price is easy to detect and prohibit, it is more difficult to secure that none of the combining suppliers shall attract customers by indirect concessions, equivalent to a reduction of price. On these and other grounds it has sometimes been found more effective to limit the amount supplied by each seller, leaving the price to be regulated by the demand¹.

The method by which Trades' Unions, and other combinations of labourers have endeavoured to increase the earnings of their members has been mainly that of fixing a price for their labour. To a smaller extent, however, they have also adopted measures tending to restrict the amount of the labour that they control. Regulations fixing the normal amount of hours of each week's (or day's) work of each labourer, so far as they have been due to the action of the unions, must have had this result; though such regulations have been chiefly advocated as a means not of increasing the aggregate returns of labour, but of diminishing the labour itself; and, actually, they have in some cases been not much more than a particular mode of fixing the price of labour, as there has been no regulation prohibiting work beyond the normal time, and such work has in fact been common. Again the restrictions which some unions have imposed on the number of apprentices taken on by the employers seem to have been mainly designed for the end of limiting supply, and must have had some effect in this direction. As I have before observed, a union open to all properly qualified workmen in any trade must in some way limit the number of those entering the trade, in order to secure permanently for its average members wages known to be higher on the whole than those earned in similar industries of the same grade. Otherwise, though the rate of wages paid to any one in actual employment might be maintained, the average wages earned from year to year would

¹ Thus, for instance, "the great coal companies of Pennsylvania and New England have at various times bound themselves to one another under pecuniary penalties not to exceed a certain output, which is fixed from time to time by a central committee." *Economics of Industry*, p. 182.

tend to be gradually reduced by an increase in the number of workmen out of employment, until the advantages of the higher price of labour were lost¹.

Hitherto we have not expressly considered the case of several products different in quality, under the control of the same monopolist. Where such differences are clearly defined, this plurality does not present any new economic problem, as the monopoly value of each separate quality of product may obviously be determined separately. But, in the case of labour, differences of quality are frequently not marked off by such definite and unmistakable characteristics as would render it easy to frame a tariff of wages accurately corresponding to them; and especially where the processes of work performed are the same, and only the manner of performing them varies, it would be very difficult for an aggregate of workers varying in efficiency to agree upon such a tariff. One way out of this difficulty, which is that commonly taken by Trades' Unions, is to fix a minimum rate, below which the ordinarily skilled craftsmen in the trade are not to accept employment².

§ 4. Let us now inquire under what conditions of Supply and

¹ It may be observed that actually Trades' Unions are not merely associations for procuring to their members the highest possible return for their labour, but also aim at providing mutual assurance for their members by means of pecuniary assistance, against the loss caused by want of employment. The "out of work pay" thus provided is, however, considerably less than the lowest wages earned by an ordinary worker in the trade. Hence any addition to annual wages secured by such a union, if admission to the trade were practically unrestricted, would be liable to be diminished in two ways; partly by the increased contribution that would be required from all members, to insure effectively against want of employment; and partly by the increased number of days during which each workman, on the average, would have to content himself with the out of work pay. If, as I am informed, no such effects as these have been observed in the case of Trades' Unions which do not practically restrict entrance into their trades, I should be disposed to infer that no such union has as yet raised the net advantages obtainable by its members above those obtainable in other industries that are on the same level as regards the outlay and the natural qualifications which they require—or at least that it has not done this to an extent generally perceptible for any considerable period. So far as this inference is not in accordance with facts, we must conclude that the mobility of labour is actually imperfect through the want of active intelligence on the part of the labourers concerned.

² This rate is frequently different in different localities. Cf. Howell, *Capital and Labour*, c. iv. § 40.

Demand it will be possible for a combination of labourers to raise their average earnings by an opportune increase of the price charged for their labour. In this inquiry, however, I do not propose to take into account the loss that may be incurred through strikes, or any expense involved in carrying on the work of combination. Of course, in calculating the actual loss and gain that have resulted to labourers from 'Trades' Unions, the loss through strikes is a very important item; but I do not think there would be any use in attempting to estimate generally the probable amount of such loss. Moreover in the cases that we consider it will very rarely be the interest of employers to run the risk of a strike, unless either they combine, or a single business is so large relatively to the particular combination of labourers as to enjoy a partial 'buyers' monopoly.' And I have already said that the normal terms of exchange between two monopolies do not appear to me capable of being solved by the methods of deductive Political Economy.

Putting strikes, then, out of the question, we may say generally that the combining labourers will gain by raising the rate at which they consent to sell their labour, so long as this does not cause the demand for their labour to fall off so much as to reduce the total amount spent in purchasing it. Such a fall in demand may (1) be expected to occur rapidly, if an adequate substitute for the monopolized labour can be obtained from other sources, at a cheaper rate (all things considered) than that fixed by the Union: this contingency, however, it will be not difficult to exclude temporarily, if the combination comprises the majority, or even a large minority, of the labourers in the country, trained to perform the processes of the particular industry; provided the rise in wages demanded be kept within such limits that the labour controlled by the Union is still cheaper, considering its superior quality, than any other labour which the employers are able to draw from other industries, or import from other countries¹. But (2) even if this contingency

¹ In the case of labour imported from (nominally) the same industry in other countries we have to consider not merely the actual cost of carriage, the expense incurred in procuring the labourers by advertisements, agents, &c., and the extra remuneration required to compensate for expatriation; but also the extent to which they will be inexpert in the methods and processes of the industry as practised in the country to which they are brought; and further, where the languages are

be excluded, the fall in the demand for the monopolized labour may be expected to occur, though more gradually, through the defection of employers, if the average profits of the latter are reduced by the rise in wages perceptibly below the profits obtainable on equal amounts of capital in other industries. There are, however, several cases in which this effect is, either permanently or temporarily, unlikely to occur to any important extent: as (a) if the employers, being wholly or partially exempt from competition, were previously able to make profits in excess of the normal rate; or (b) if, apart from the rise in wages, they would be in a position to do so temporarily owing to a simultaneous rise in the price of their commodity through intensification of the demand, or to a fall in its cost of production through invention, cheapening of material, &c. It is to be observed that in the latter cases, an ultimate rise in wages might be expected to occur, even if there were no combination of labourers; since the increase in employers' profits that would then take place would tend to cause an extension of business and an intensified demand for the appropriate labour. Still, the gain that would thus accrue to the labourers might easily be less on the whole (as well as later in time) than the increase in wages obtainable by combination.

Again, if the commodity sold by the employers is of such a kind that an increase in its price tends but slightly to reduce the consumers' demand for it, so that the aggregate expenditure on the commodity is increased, the additional cost of production due to a rise in wages may be entirely thrown on the consumers, without any material reduction in the amount produced, or in the employers' demand for labour. And this is likely to be the case with any commodities which are regarded by the consumers as indispensable, except so far as the employers of the combining labourers are closely pressed in the markets which they supply by the competition of producers who are unaffected by the combination.

Further, a rise in wages may often be temporarily secured, without a corresponding reduction of business, even though the employers' profits be thereby reduced considerably below the

different, the cost of interpreters, and the loss occasioned by inevitable misunderstandings on the part of fellow-labourers and others. Cf. Howell, c. ix. § 13.

normal rate, if their industry is one that uses a large amount of fixed capital. For in this case the employers are often unable to diminish their employment of labour materially, without proportionally reducing the yield on their fixed capital: and the loss thus incurred may be greater than that involved in paying the higher wages to their full complement of labourers. Indeed, in certain circumstances—as for instance, if an employer has contracted to do a certain amount of work under heavy penalties, or if he has a large stock of raw material that will deteriorate by being kept, or even merely if he is seriously afraid of losing his business connexion—it may be expedient for him to continue his production, even if he earns less than nothing for his labour and the use of his capital. But under such circumstances the gain to the combining labourers can obviously be only temporary, the period during which it can last being limited in proportion to the severity of the employers' loss: and it is not improbable that the ultimate loss to the combining labourers from the diminution of employment may decidedly outweigh the immediate gain.

In all the above cases it is possible for a combination of workmen to secure, either temporarily or permanently, a rise in wages; while in none of them, except the last, has such gain any manifest tendency to be counterbalanced by future loss. And it does not appear that these cases are in practice very exceptional: or that the proposition that “trades’ unions cannot in the long run succeed in raising wages” corresponds even approximately to the actual facts of industry. I am not, however, aware that any economist of repute has maintained such a proposition—whatever may be the case with indiscreet disciples. All that Mill and his chief followers have argued is, that if one set of labourers obtain an increase of wages in this way, there must be a corresponding reduction in the wages of other labourers. Even if this were so, there hardly seems to be any reason why the labourers in any particular industry, supposing them to be “economic men” of the ordinary pattern, should be expected to sacrifice their interests to those of certain other labourers unknown. Still the conclusion, from the point of view of the philanthropist, is so important that it is worth while to show in detail that there is really no ground for drawing it.

The doctrine is, in fact, a deduction from that combated in Chap. VIII., under the name of the "Wages-Fund Theory," according to which the share of labour in the aggregate was "taken as predetermined" in the aggregate bargaining between (employing) capitalists and labourers, and therefore as incapable of being altered by the successful bargaining of any one set of labourers. According to the view that I have maintained of the relation of capital to labour, we have no ground for supposing this "predetermination." It is no doubt true, according to my view, that any increase in the wages of hired labour not accompanied by an equal increase in its productiveness, has some tendency to cause a reaction and subsequent inevitable reduction in the remuneration of such labour, so far as such increase involves a reduction of the rate of interest in the country; since any such reduction must tend to check the supply of capital for home investment, and so ultimately to raise interest again, at the expense of wages. But there is no reason to suppose that this ulterior loss to hired labourers in the aggregate will generally tend to counterbalance their previous gain; and there are several possible cases in which the above-mentioned effect on interest will either not occur at all, or be slight in comparison to the rise in wages. Thus in the first place, when the increase in the remuneration of any class of labourers causes a corresponding increase in their efficiency, through their being more amply supplied with the necessaries of life, the gain of these labourers involves no corresponding loss to any other class. Again, so far as any rise in wages diminishes the extra profits which a particular class of employers, having certain special advantages, were previously able to make, the loss caused by it falls primarily on the wages of management of these employers; and whatever ultimate effect it may have in reducing the rate of interest is not likely to be great in proportion to its primary effect. Finally, so far as the addition to particular wages is entirely or mainly paid by an increase in the exchange value of products consumed chiefly by the rich, though there will be a consequent loss to capitalists as consumers, and thus a diminution in the real income derived from capital, there will not therefore be any diminution in interest regarded as a motive to accumulation.

In none of these cases, then, does a gain obtained through combination by one set of hired labourers tend to cause anything like an equivalent loss to some other hired labourers. There are, no doubt, many other cases in which such loss tends to be ultimately considerable, and may outweigh the immediate gain, from the point of view of labour generally, even if we leave the effect of strikes out of account. The loss in question is produced chiefly in three ways; (1) an increase in the cost of any particular kind of labour, so far as it causes a rise in the price of products consumed by other hired labourers, tends to diminish the real wages of the latter; (2) any reduction in the sale of the labour furnished by a particular class of workers, accompanying or resulting from a forced rise in their wages, tends *pro tanto* to prevent some actual or possible labourers of the same class from consuming as much as they would otherwise do; (3) the same cause tends more indirectly to reduce the demand for other kinds of labour employed either in the same industry, or in other industries cooperating directly or indirectly to produce the same consumable product.

So far I have been considering the operation of Trades' Unions, or other combinations of labourers, in restricting the supply of labour either directly or indirectly by raising its price. But, before concluding this inquiry, it should be observed that combinations of workers, avowed or tacit, have sometimes sought with more or less success to increase their earnings through an enlargement of the demand for their work; by enforcing the use of more laborious processes of production than are necessary for the result desired by the consumers of their products. Such artificial enlargement of demand is more obviously injurious to society than an artificial restriction of supply; since the extra labour of which the use is thus enforced is, from a social point of view, palpably and undeniably wasted. Hence this mode of increasing the aggregate wages of a class of workers seems to be rarely adopted in an avowed and unqualified way: that is, the more laborious process maintained by combination commonly produces, or is believed to produce, a result somewhat superior in quality to that which could be obtained by less labour, though the difference in quality by no means compensates for the additional cost.

CHAPTER XI.

TRANSIENT AND LOCAL VARIATIONS IN DISTRIBUTION.

§ 1. THE more important conclusions reached in the five preceding chapters may be broadly summed up as follows:

The whole produce of the labour and capital employed in any country, the whole increment of its wealth in any given year, will be greater or less—other things being the same—according to the quantity and efficiency of its labour: while the supply of labour, in a thickly peopled country, will be greatly influenced by the amount of produce *per head* that falls to the labourers; and again the efficiency of the labour will depend largely on the amount of aid that it receives from capital, the accumulation of which is materially influenced by the rate of interest. The earnings of labour in the aggregate (including the labour of management) may be most conveniently regarded as consisting of this total produce, after subtracting whatever payment has to be made for the use of the accumulated results of previous labour and appropriated natural agents. Industrial competition operates continually, with certain qualifications and within certain limits, to equalize the shares in which such aggregate earnings of labour are divided among the labourers; still, the wages of different classes are characterized by very striking inequalities which industrial competition has no direct tendency to remove. These inequalities are partly compensatory for inequalities of sacrifice or outlay undergone either by the workers themselves or their parents; but, in such a society as ours, the most striking of them—if we exclude the effects of monopoly—will probably be due in a great measure to the scarcity of persons duly qualified, through their own wealth or

their parents', for the performance of certain kinds of work. The limitation of numbers necessary to this result would not, however, be generally speaking maintained, if the standard of comfort habitual in each grade of society did not place an effective check upon increase of population within the grade. This check may be importantly aided by the attractions which the prospect of higher wages abroad exercise on different classes of labourers; since the average real wages of any class can not remain below the real wages which the labourers in question believe to be obtainable by them in another country, by an amount materially more than sufficient to compensate for the prospective cost and trouble of obtaining it, and the sacrifices involved in expatriation, as estimated by the persons concerned; provided that the outlay required is not actually beyond their means.

Another cause of variation in the wages of different kinds of labour is the fact that certain classes of persons possess natural qualities, physical and intellectual, which are scarce relatively to the demand for their labour; and this is, even more manifestly, a cause of differences of remuneration among individual members of the same class. Skill peculiar to a single individual renders its possessor a monopolist of the special commodity produced by his skill; and this monopoly may enable him to increase his income very considerably, if there be a keen demand for his commodity. Similar advantages, varying in extent and duration, may be gained by a combination of persons specially skilled. If the labour controlled by such a combination were strictly indispensable to the production of some strictly indispensable commodity, the combined labourers would have it in their power to exact such a price for it as would strip the rest of the community of all their superfluous wealth—that is, if we can suppose freedom of exchange to be legally maintained under these hypothetical circumstances. Practically such a case has never occurred: even where the need which the monopolized labour supplies is one which must be satisfied, some substitute can always be found either (1) for the labour or (2) for the consumable commodity which it is a means of producing; and this possibility of substitution fixes a limit to the price which the monopolized labour can obtain.

A specially remarkable instance of inequality in the remuneration of labour is furnished by the earnings or wages of management of the employer as such; since such wages tend to increase with the amount of capital employed to an extent more than proportioned to the consequent increase in the labour of management; owing to the scarcity of employers individually controlling large capitals, as compared with the field of employment for such capitals, and to the superiority, on the average, of the work done by an employer who labours for himself alone, as compared with the manager of a jointstock company.

Turning to the yield of capital itself, we observe that the returns from certain investments may be kept above the ordinary rate of interest on the original outlay—just as the remuneration of labour may—through the operation of monopoly or scarcity. A chief case of this is the rent of agricultural land in thickly populated countries, which is kept above ordinary interest on the outlay of which its utility is the result, by the limitation of land equally available for supplying the same markets with agricultural products: the excess of yield being due partly to the natural qualities of the soil, partly to the distribution of the population that purchases its produce. In some cases—such as the ground in towns or the ground containing rich minerals (supposing no outlay to have been incurred in discovering them), the payment of rent is wholly to be referred to the appropriation of a scarce natural agent. A similar operation of monopoly or scarcity is exhibited by the high dividends often paid on the stocks of water-companies and gas-companies, and other investments which, either through legal interference or the force of circumstances, are wholly or partially exempt from competition. In all these cases, the normal extra yield of the land or capital in question is determined merely by the excess of the price of whatever amount of its produce it is found most profitable to bring to market, over the cost of producing it—allowance being made for any rise or fall in the value of the land (or fixed capital) employed, which may be caused by the process of production itself. An analogous extra yield, again, is obtained by manufacturers who use processes protected from imitation by secrecy or legal monopoly, and by houses of business that have an established connexion; and though such extra profit may be

properly regarded as interest on the results of the labour applied in inventing and perfecting a new process or establishing a business, it is often much in excess of ordinary interest on such outlay, when the labour has been applied under specially favourable social or industrial conditions.

On the other hand the yield of capital fully exposed to competition, and not capable of being transferred without loss from the investment in which it has been placed, cannot on the average be higher than ordinary interest on the original outlay; and is liable to become indefinitely less than this, through changes in the arts of industry or in other social conditions. Nor is this liability absent, even in the case of capital partly exempt from competition.

Current interest, or the price obtained for the use of capital continually available for new investment, tends to be approximately the same for equal amounts of such capital invested for equal periods, allowance being made for differences in the security of different investments, and in the expectations of their future rise and fall. Such interest is partly paid for wealth employed in production, and partly for consumers' wealth previously lent and consumed, either by living individuals or those whose obligations they inherit, or by the community to which they belong; in this latter case the debts on which the interest is paid are to be regarded as invested capital of *individuals*, though not of the community. The ratio of this payment to the value of the principal is mainly determined, in a modern industrial community in which wealth is continually accumulated, by the utility to industry of the last increment of the capital productively invested; this utility, again, depending on the relation between the supply of available capital and the field of profitable employment for it, which latter tends to grow larger as population increases—though not in proportion to such increase after a certain point of density has been reached—and which, in recent times especially, has been continually and greatly enlarged by the progress of invention. Since, however, the accumulation of capital in a country is influenced by the rate of interest, it may be assumed with great probability that there is, at any given time, a certain minimum rate necessary to induce saving sufficient to balance the waste of capital that is

continually going on; and that as current interest sinks towards this minimum, accumulation will be more and more retarded. The supply of capital in a country, however, tends to vary from many other causes besides changes in the rate of interest there; in particular, owing to the international mobility of capital, the supply in any one country tends to be affected by any material changes in the field of employment for capital elsewhere; and also by any change—due (e.g.) to increase or decrease of mutual confidence—in the general estimate formed in any one country of the risks attending investment in another.

§ 2. The rates of remuneration for different industrial services, as they tend to be determined by the operation of the general economic causes above analysed—except Combination, which requires exceptional treatment from the difficulty of forecasting its effects, if we suppose it generally adopted—may be designated as the Normal rates. At any particular time and place, the actual shares of produce received by members of the different industrial classes as such are likely to vary somewhat from the normal shares, under the influence of transient or local causes which I now propose to examine;—confining myself mainly to causes actually operative in the most advanced industrial communities, and not incompatible with the general assumptions on which our theory has proceeded. We ought, however, to begin by noting that the normal shares themselves are likely to be continually fluctuating; since there is no reason to assume that any of the general causes that influence them operate in precisely the same manner or degree for any length of time. We have already observed that both the total produce of industry, and the proportions that fall respectively to labour and to capital, tend to be continually altered by the changes that constitute the normal growth of a prosperous community—the accumulation of capital, the increase of population, improvements in the arts of industry due to invention, and the development of cooperation, especially cooperation through exchange. We have seen, too, that the growth of population within a given area tends on the one hand to increase the advantages of cooperation; but that on the other hand, after a certain pitch of density is reached, it tends to diminish the efficiency of labour in agriculture, through the increased diffi-

culty of agricultural production, while at the same time the proportion of the produce paid for the use of land tends to increase. Then, turning to the normal distribution of the aggregate earnings of labour among the different classes of workers, we can easily see that it will be modified in various complex ways; by changes in the distribution of wealth, altering the supply of persons capable of making a given amount of outlay; changes in the processes of industry, altering the demand both for natural qualities and for the results of training, and also altering the sacrifices required for the production of certain utilities; changes in the cost of production of certain kinds of skill, through the spread of education, &c.; changes in social habits and opinions, modifying men's estimate of certain kinds of sacrifice, and further altering the relations of the demands for the different grades of labour respectively; and other changes too numerous to mention.

Again, the continual oscillations in the market-price of commodities which we have noticed must be accompanied in most cases with corresponding oscillations in the profits of those who supply the commodities in question; owing to the inevitably unstable adjustment of supply to the generally varying demand. The forecast of the demand for a commodity—at any supposed price—can at best be only approximative; though with some commodities—such as a staple of food—the approximation can be made much more close than with others; in most cases, however, besides the larger alterations in demand which I shall notice later, there will be continual small tides of change from complex causes that defy calculation. And even supposing the demand for any product exactly known to all suppliers, it is still highly unlikely that at any given time supply should be so adjusted as to give the suppliers the exact remuneration that industrial competition tends to allot to them. Indeed in agriculture, hunting, and some kinds of mining the produce obtainable by a given amount of labour frequently varies very considerably on either side of the average; and it may be remarked that, supposing such variations to affect all producers about equally, it depends on the precise nature of the demand for the product whether an abundant supply will be profitable or the reverse: since if the demand is inelastic—as it is (c.g.) for

corn—the producers may easily gain by dearth and lose by plenty.

Finally, even the larger fluctuations that affect different branches of production—which we have now to examine more in detail—have already been noticed incidentally in considering the general determination of Interest; since we had to distinguish that portion of the returns actually received from investments of capital which is practically compensation for risk. Now it belongs to the very notion of ‘risk’ that we cannot predict when or how far the loss, of which we recognise a certain probability, will actually be incurred; hence even if such expectations of risk were altogether well-founded, it would be in the highest degree improbable that all owners of capital should incur the same proportion of loss in any particular year. Similarly we have taken note of ‘uncertainty’ as one cause of the difference in the actual remunerations of labour. Here, however, it should be observed that there is practically a much more exact comparison of prospective remunerations made by persons investing capital than by persons selecting a line of labour. Very slight differences in the prospective security of interest, which would have no effect on the choice of a trade or profession, find expression in the different prices of different investments of capital—thus, for instance, the faint additional chance of the non-payment of interest on the preference shares of a first-class English railway causes such shares to be sold at a somewhat lower price than debentures of the same railway yielding the same interest. Similarly if a small capitalist is considering whether he shall go into a business, he takes into account indefinite and remote risks which can hardly enter into the view of an ordinary labourer choosing a trade for his son: for the uncertainties of which Adam Smith speaks, that tend to be compensated in the higher wages of particular trades, are dangers frequently incurred in the course of the ordinary experience of such trades. Accordingly the exceptional losses of different classes of capitalists and employers tend to be compensated by higher incomes in ordinary times to a greater extent than similar losses incurred by hired labourers. On the other hand, the fluctuations in the profits of capital employed by the owner, and even in the mere interest of

capital that bears the full risks of industry, appear to be decidedly greater on the average than the fluctuations in the remuneration of hired labour: because under the existing conditions of industry profits are the "leavings of wages," so that the capitalist employer mostly bears the first shock of unforeseen losses, and only passes on a part of the blow to his employees; and, in the same way, he mostly secures the lion's share of unforeseen gains.

§ 3. Let us then proceed to consider more in detail the causes and effects of the more important fluctuations in the profits of different industries: and, since the danger of loss occupies a larger place in the common view of industrial capital than the chance of extra gain, we may conveniently begin by directing our attention to the former phenomenon. Of course so far as we are merely dealing with changes in distribution, loss and gain—to different sets of persons—are correlative effects of the same causes. But important changes in distribution are mostly accompanied by some increase or decrease in the aggregate wealth of the community; and it may be observed that in estimating this aggregate effect, we are often liable to strike the balance wrongly between gain and loss; since the lesser of the two correlative effects, being the more concentrated, is often more obvious and striking.

Losses in business which impair aggregate wealth as well as the wealth of individuals may be due, firstly, to dishonesty; or, without distinct dishonesty, to the pursuit of private interests by the employers of borrowed capital, with more or less culpable indifference to the interests of the persons who own the capital. Or, secondly, they may be due to mere mismanagement of the routine of business—want of care and punctuality in meeting requirements, want of vigilance in supervising subordinates, &c. These causes, however, are hardly likely to affect specially any particular branch of production; and therefore most of the damage due to them will remain with the owners or employers of the capital in question. But a third class of losses, which arise from want of the higher kind of business talent,—viz. foresight as to important changes in supply or demand, and inventiveness in adapting production to meet such changes—being liable to affect whole classes of employers simultaneously, have a much

greater tendency to be passed on to the classes of labourers employed by them. It is hard to draw a line in any case defining how much of this kind of loss should be regarded as the normal penalty of unskill, and, similarly, how much of the corresponding gain from favourable changes is the normal reward of superior ability; since it is difficult to place definite limits to human foresight and ingenuity. But at any rate there is a good deal of actual loss and gain which we must place beyond the line, and consider—economically speaking—as beyond the scope of prescience and provision; and it would seem that the development of industry and trade tends to increase both the number and magnitude of such unmerited fluctuations of income; though it also tends to mitigate their worst effects on human life and happiness.

In examining further the operation of such accidents, we may notice first those that strike industry, so to say, from without; that is from causes independent of the conditions of its own normal progress under a system of free competition. Such are the calamities of unusually bad seasons, plagues of noxious animals, epidemic diseases among useful animals and vegetables, extensive damage from flood or fire, &c. Losses caused in this way almost always fall with unequal weight on different portions of the community; in most cases they are borne primarily by employers engaged in the branches of industry affected; a varying portion of the loss being passed on to the consumers of their products, the labourers whom they employ, the owners of the land and borrowed capital which they use, and the other producers whose products they consume¹. The same may be said of the destruction of property caused by war; though it is to be observed that so far as war, disease, or other calamity destroys human life, its effect on the amount of wealth *per head* possessed by the community is of a mixed kind: since the survivors, whatever they may lose by such calamities, will at any rate gain relief from the economic disadvantages of overcrowding.

¹ It has been observed that the producers of commodities for which the demand is of such a kind that—within certain limits—each diminution in supply tends to increase the price paid for the total amount sold, may actually gain as a class by any such disaster; the consumers suffering, through the rise in price, a loss greater than that which falls on the community as a whole.

Accidents of this kind favourable to production also occur, though more rarely; the most striking of these are chance discoveries of natural products suitable to human use, as in the finding of rich mines. Such discoveries however, are more commonly made by minds that have spent time and energy in searching for them; in which case they come under the general head of Invention, the great spring of industrial progress.

More ordinarily, important changes due to invention consist in the discovery not of new sources of raw material, but new modes of adapting known materials or forces to the needs of industry. Such improvements in industrial processes of course tend to make the community ultimately richer, inasmuch as they increase the amount of a given kind of commodity obtainable by a given amount of labour. But, generally speaking, they tend also to reduce the value of a certain amount of the capital already invested in instruments of production. Hence their effects on the wealth of the community at the time of their introduction are necessarily mixed; and may be, on the whole, of a negative kind. It is even conceivable that some very important invention might reduce the value of previously existing instruments and stocks so much, that the total capital of the community would actually be diminished by an amount exceeding the value of the new commodities produced within the year; so that the community would appear to be spending its capital, in consequence of what was really a great step in the advance of material wellbeing. This paradox is the inevitable result (in the case supposed) of including in one aggregate of wealth, along with things immediately consumable, products that are only useful and valuable as a means of producing the former: but, since most of that part of real incomes which is saved exists normally in the form of such merely instrumental products, I do not see how we can conveniently adopt any other view of wealth, in discussing Distribution. We must therefore be content to note the possibility of this paradoxical result, and to guard ourselves against being misled by it.

So great a destruction of the existing value of capital as that above supposed is highly improbable; but minor effects of this kind are, as I have said, a normal incident of industrial progress; and, in considering the effects of new inventions on

distribution, must be set down as losses, which may temporarily more than counterbalance the economic gain of such inventions.

This gain itself will be distributed in very various ways according to circumstances. Supposing that the invention can be monopolized, through a patent or otherwise, the extra profit that its possessor can secure—which is, of course, to be regarded as the normal reward of the inventor's labour—may conceivably be equivalent to the whole of the economic gain obtained by the improvement. But, generally speaking, the monopolist will pass on a portion of this gain to others, and ultimately to the consumers; since, if (1) the improvement consists in cheapening the manufacture of some old product, it will generally be his interest to sell this at a lowered price, in order to secure possession of the market; while if (2) it leads to the production of some new consumable commodity, it will be necessary to sell this to the consumers at such a price as will give them a share of the additional utility obtained by it, in order to induce them to alter their habits of purchase. Supposing, on the other hand, that the invention is not protected from imitation, competition will tend ultimately to transfer the whole gain to the consumers; but generally speaking a certain portion of it will, during an interval varying in length, be retained as extra profit by the employers who first use the invention; who may either be some or all of the persons whose fixed capital has been depreciated by the improvement, or a quite different set of persons—according as the industrial change in question is more or less sweeping in character.

The effects of such a change on the remuneration of manual labour are similarly complex and various. It is obvious that the value of what we have before called the 'personal capital' of skilled labourers—their acquired dexterities—is liable to be diminished or annihilated by improvements in industrial processes, just as the value of material instruments is. On the other hand, the fall of price caused by an improvement frequently extends the consumption of the products of the industry affected so much, as to increase considerably the total employment offered to labourers engaged in it, and to raise the price of the kind of labour required to work the new process. If, however, this extension of consumption does not take place, the

introduction of a 'labour-saving' improvement in any branch of production must necessarily diminish the total amount of labour employed in it; and since if the change takes place rapidly the labourers thus turned adrift will often find it difficult to obtain work elsewhere, it is not surprising that improvements in industrial processes should have been thought to diminish the whole field of employment for labour; and that at various times not unenlightened persons should have fancied that they were acting for the interest of the community in endeavouring to prevent this result. But, it is obvious that, if of two processes equally efficient the more laborious is chosen, the utility to the community of the extra labour thus employed is simply *nil*; and there must always be some other department of the industrial system in which it could be applied productively, though probably with a diminished 'final utility', and therefore at a lower rate of remuneration.

What has been just said of the effects of newly invented improvements in the process of manufacture, applies equally to the application of inventions already published, but neglected for want of knowledge, enterprise or capital; except that the element of possible monopoly is absent in this case. Similar effects are also produced by improvements in communication and conveyance, and the opening up of new lines of trade¹; but a full consideration of these would bring prominently into view local variations in industrial incomes, which I reserve for discussion later on.

Again, it may be pointed out that improvements in any branch of production, if they materially increase or decrease the value of its aggregate products, tend to cause secondary changes in the demand for the products of other industries, which may in some cases be important; thus if corn be materially cheapened, the demand for the luxuries of the poor may rise to such an extent as to raise temporarily the profits and wages of the producers of such luxuries above their normal amount. The new investments of capital to which invention

¹ At an earlier period of our industrial history it was usual, and perhaps useful, to encourage and protect developments of trade by legal monopolies, no less than improvements in manufacture. But in the present state of commercial enterprise such artificial encouragement would seem quite superfluous; and is universally condemned by modern maxims of economic policy.

leads are similarly a source of temporary extra gains to the producers of certain kinds of instruments and materials; thus (*e.g.*) the introduction of railways benefited employers and labourers engaged in the production of iron.

§ 4. Further important changes in demand continually occur, with effects similar to those just mentioned, independently of any amelioration in the processes of manufacture. To a certain extent, indeed, such changes are, in a larger sense, to be regarded as economic improvements; that is, when a general preference on the part of consumers for some commodity different from what they have previously been in the habit of purchasing is occasioned by the fact that a better or cheaper means of satisfying some need has become more generally known or appreciated. But some alterations in demand, that affect production materially, are due to the mere caprice of fashion, and thus involve no real advantage to the community. Either kind of such changes when abrupt and extensive may inflict the same kind of loss on certain portions of real and personal capital that we have seen to be an incidental effect of many industrial improvements; and may similarly affect the relative demands for certain kinds of labour.

Even if we suppose no change either in the arts of industry or the habits of expenditure corresponding to different grades of income, many important changes in the relative demand for the products of different industries must continually result from the increase of wealth and population, and from the larger changes in distribution which these tend to bring with them, through the operation of the normal conditions already investigated.

As I have already said, the highest kind of business talent is shewn in forecasting rightly all these various changes and continually adapting supply to demand; but the forecast tends to become more difficult as the range of cooperation through exchange extends. Producers are more and more led to manufacture for markets too numerous to watch carefully, too remote to understand adequately, and exposed to modifying influences of continually increasing complexity; and hence fluctuations in the adaptation of supply to demand, and consequent fluctuations in the incomes of producers, tend to become greater and to contain

a larger element of mere luck. Manufacturers and traders working under these conditions have frequent and important occasions of gain through unexpected developments of demand ; but they are also in continual danger of loss through over-supply of their commodities. Indeed any considerable gain is liable to tend indirectly to subsequent loss, by the exceptionally eager competition excited in the business that has suddenly become profitable. The excess of production thus caused sometimes leads to such a fall in the price of the over-abundant products that their market-value does not exceed that of the materials spent in making them—or, in the case of trade, the value of imported goods does not exceed their value in the country from which they were brought—thus allowing no return whatever to the labour and capital employed in the production ; or rather, as the employed labourers will generally have received their wages, a proportionate amount of the employer's capital must in such cases be wasted in the purchase of valueless work. Over-production of this kind—even if it does not reach this degree—is a striking feature of the modern competitive organisation of industry, extended as it is by worldwide trade ; and, owing to the intimate connexion of different branches of production, fluctuations of this kind rarely affect one branch alone, and frequently occur nearly simultaneously in a considerable number. This experience has in former times led even professed political economists to the conclusion that *general* over-production is a danger against which society has to guard ; that the aggregate of labourers cooperating through exchange are liable to produce not only too much of a certain kind of commodity, but too much altogether. Now it must be admitted that this result is a possible one ; an individual may obviously be led, from an over-estimate of the utilities obtainable by his labour, to work harder than he would otherwise think it worth while to do ; and what is possible in the case of any one worker is possible in the case of the aggregate of workers. And I think further that this result may be expected to occur, to a certain very limited extent, when any branch of industry is abnormally stimulated by high prices ; since under these circumstances the energies of employers and employed are often strained to an unusual degree, and a certain margin of extra labour is likely

to be called forth, which would not have been exerted except for the high rate of remuneration which it is mistakenly supposed to be worth. But this margin—even supposing it not to be counterbalanced by an equal or greater reduction of labour elsewhere—will generally be so small a part of the whole labour thus employed that it may for practical purposes be neglected; practically the over-production of certain commodities of which we have actual experience may be regarded as merely mis-directed production. Indeed we may lay down, that, owing to the defects in the actual organisation of industry, which result inevitably from the limited knowledge and imperfect mutual communication of its members, society is always in a condition of *under-production*; *i.e.* there is always a considerable amount of available labour unemployed, for which the conditions of industry might actually afford remuneration sufficient to bring it into employment.

Still, however they may be caused, the extensive miscalculations of supply that produce the effect of general over-production, tend equally to depress the remunerations of employers and employed in certain branches of industry below the normal rates, and to depreciate the capital, real and personal, that has been invested in them. Indeed, when the miscalculation has been great, it may even annihilate the value of large portions of such capital, if it is of a kind that cannot be turned to other uses without great loss.

§ 5. We have now to observe that such over-production will often be accompanied by important fluctuations in the rate of interest, and therefore will produce effects on distribution beyond the range of the special branches of industry in which the miscalculation has taken place. This will be especially found to be the case if the over-production has been due to a wide-spread over-estimate of the profit to be obtained by new investments of capital—whether in the form of additional stocks of consumable goods, destined for new openings of trade, or in railways, ships, machines and other durable instruments. We have already noticed that the demand for new capital to be productively invested depends at any particular time not upon the actual productiveness of such capital, but upon the general estimate of what it will produce. There seems, indeed, no

ground for supposing that this estimate tends, on the average and in the long run, to diverge decidedly from the facts in either direction. But experience shews that the general view of the possibilities of profitable employment of capital is liable to marked ebbs and flows. Sometimes there is a general disposition to overrate it, "times of confidence," in which the over-production of which we have been speaking takes place. At such times the employers who cause the over-production avail themselves largely of the capital of others; borrowing is extended, and an unusual number of joint-stock companies are formed; in consequence of which the rate of interest rises to an unusual height. Then when the miscalculation has become manifest, numerous bankruptcies and wide-spread depreciation of the new investments occur; really sound investments are affected by the ruin of the unsound; the general confidence is succeeded by general distrust; and the rate of interest falls again, not merely down to, but below, the normal rate.

In these fluctuations, the rate of discount or interest charged by bankers for the use of the medium of exchange commonly fluctuates more than the rate on investments generally, as the demand for loans made by bankers increases more in proportion than the demand—made mainly by joint-stock companies—for the capital of private investors. And if the transition from confidence to distrust is sudden and sharp, it is liable to cause a very violent fluctuation in the rate of discount; bankers refuse to make loans on conditions which they would ordinarily consider acceptable, partly through fear of the bankruptcy of the applicants, partly from the necessity of protecting themselves against the consequences of a similar distrust; and thus the extreme scarcity of *trustworthy* medium of exchange forces up the price of it to an abnormal height; money being everywhere wanted, not for enlargement of purchases, but for the payment of debts already incurred. At such times there will also be a rise in the rate of interest on invested capital generally, not from an increase in the total amount of interest received, but from a fall in the selling value of securities; which are extensively sold owing to the urgent need of ready money and the high price paid for the use of it. This latter change, of course, does not affect the real income of persons who continue to hold these

securities; but it involves an accidental gain to all who are at the time investing, at the expense of those who find it needful to sell their investments.

Again, other causes besides miscalculation of prospective profits on the part of employers of capital may produce a transient rise in interest. Thus the commencement—or merely the fear—of a drain of gold from banks, for the payment of a balance of debt on the trade of the country or some other cause, may lead bankers to raise the rate of interest, in order to bring back the gold or turn the balance the other way. Such a rise in the rate tends to have the desired effect in two ways: it tends to lower prices,—because it makes holders of commodities or securities prefer selling to borrowing money, and similarly diminishes the willingness to purchase—and thus encourages exportation and discourages importation; and secondly it increases the disposition of foreign creditors to allow the debts due to them to run on, in order to obtain the higher interest.

This leads me to notice another important class of variations in Distribution, that tend to accompany critical changes in the rate of interest charged by bankers; viz. those due to variations in the purchasing power of money. I have before explained how the price paid for the use of money and its general purchasing power tend to vary concomitantly to a certain extent, and under certain circumstances—though under other conditions they are more likely to vary in opposite directions; and I have shewn how this concomitance comes to be especially marked at financial crises. Indeed in a country where the use of bankers' obligations as a medium of exchange is general, and where the dangerous resource of inconvertible notes is eschewed, the most rapid and impressive variations in the purchasing power of money are those due to the vicissitudes of the banking system; but the more durable, though slower, variations caused by changes in the relation of the supply of bullion to the demand for it, also produce very material effects on the distribution of incomes. These effects are of a somewhat complex kind. It is obvious that a rise in the purchasing power of money is advantageous to all creditors, including all annuity-holders, and all persons whose incomes are legally fixed, and disadvantageous to all debtors; but it should be noted that

it is also at least temporarily advantageous to all persons whose rates of remuneration have a partial stability through the mixture of custom¹ and informal combination of which I have before spoken; that is, to large classes of labourers. For both reasons, therefore, it is disadvantageous to employers of capital who are generally borrowers, and at the same time employers of labour. It thus acts as a discouragement of industrial enterprise, and in this way may cause some detriment indirectly even to the labourers whom it primarily benefits. Similarly a fall in the purchasing power of money causes a sensible diffusion of good fortune among employers of capital and labour; the benefit of which is not unlikely to be ultimately shared by the labourers whom they employ, though immediately these latter tend to lose through the comparative immobility of their money incomes; while all who are legally entitled to fixed money-payments lose, of course, without compensation.

§ 6. In considering changes in the purchasing power of money, it is important to observe that such changes are only gradually transmitted, and with unequal rapidity from one part of the country to another; and also that in the same district some industries are slower in feeling their effects than others. Such inequalities are obviously due to differences in the nature and extent of the traffic carried on, directly or indirectly, between the districts in which money is produced—or the emporia of foreign trade through which it is obtained from abroad—and other parts of the country. But in order to understand these differences thoroughly, it will be convenient to take a view of the variations that tend to be found normally in the prices of any commodity, and in the general purchasing power of money, as we pass from district to district. These variations are due primarily to the localization of different branches of production (including exchange) in different places; which is itself traceable to a combination, sometimes rather intricate, of physical and historical causes. The most obvious of such causes are the natural economic advantages which some parts of the earth's surface offer for certain industries: thus minerals will

¹ It should be remembered that we are contemplating a society in which Custom pure and simple is supposed not to interfere materially with the action of Competition.

evidently tend to be produced where they are most abundant and most easily extracted, and agricultural products where soil and climate are most favourable: large centres of trade will be formed near the mouths of navigable rivers, and manufactures will flourish where the raw or auxiliary materials employed in them are easily obtainable. But in any explanation of the actual distribution of industries in the complex group of communities now more or less united by trade into one industrial system, a large place must be given to the influence of differences of race, social condition and political circumstances among the persons inhabiting different localities. It would take us too far afield to analyse these historical conditions: what we are rather concerned to observe is that when once an industry has been successfully established in any place, through whatever combination of causes, there is a certain economic *vis inertiae* tending to maintain it there—and to increase it in extent, if the increase of population and wealth increases the demand for its products within a given area, or if improvements in communication enlarge the area which can be profitably supplied from one centre. This *vis inertiae* may be analysed into several elements, variously combined in different cases. Partly, a manufacturer who started elsewhere would have more difficulty in obtaining a market for his commodities, from the established reputation attaching to the locality in question: (*e.g.*) equally good hardware made at Halifax would not command the price of Sheffield hardware. Partly, again, he would have more difficulty in obtaining the requisite skilled labour: while further, especially in departments of industry in which the subdivision of employments has been carried to great lengths, any one branch of production tends gradually to have collected in its neighbourhood auxiliary and connected, but separately organised, industries; so that a producer by settling in this neighbourhood has superior facilities for obtaining the materials or instruments he requires.

Through this combination, then, of physical and historical conditions it comes to pass that the main part of the demand of a region often very large, for commodities of a certain quality, tends to be supplied from a district or districts, the extent of which is but small—sometimes insignificant—in comparison

with the whole area¹. And, to meet the expense of carriage, the money-price paid by consumers for such commodities tends to increase, roughly speaking², in proportion to the distance that separates the consumer from the centre of diffusion. But it is to be observed that the real exchange-value of the commodities may vary somewhat differently from the money-price; since money itself tends to have somewhat different values in different districts. For instance, in a country which obtains its coin and bullion from abroad, the purchasing power of money will tend to be appreciably higher in districts unfavourably situated for exchanging commodities, directly or indirectly, with the emporia of foreign trade;—that is, districts between which and the places with which they trade the cost of carriage is high, while there is no such keen demand for their products outside as would enable them to throw the greater part of this cost on their customers. The theoretical maximum of possible difference between the exchange values of money in any two districts compared is constituted, as we have seen, by the cost of carrying money one way and some kind of goods the other way; but in an advanced industrial community with a fully developed banking system, the cost of carrying money itself may be neglected, at least in comparing districts not very remote, and we need only consider the cost of carrying goods. This cost and the resultant differences will of course vary with the facilities, natural and artificial, for transport; hence prices may be more nearly equalised at comparatively remote places in the neighbourhood of a coast or a railway, than at places comparatively near each other, but connected only by indifferent roads.

Further, it is to be observed that local variations of prices will be more marked in the case of commodities that are either heavy in proportion to their value, or liable to injury during

¹ Where, as in all industries except agriculture, this development of trade leads to the close aggregation of a large number of labourers, the resulting inequality in the distribution of population is increased by the further aggregation of retail traders and artisans to supply consumable commodities to the other aggregate.

² The interest that manufacturers and traders generally have in extending their business, induce them sometimes to take a part—or even the whole—of this cost on themselves, in transmitting their products to distant consumers.

transport, than in the case of lighter and more durable or more safely portable articles. And since in these various ways the differences in the exchange value of money, as between any two districts compared, will tend to be different in relation to different commodities; it may easily happen that the practical purchasing power of money will have different local variations for different classes of incomes. Thus an unskilled labourer's money wages may go further in a remote rural district, owing to the cheapness of the food, fuel and house-room which they are chiefly spent in providing; while to a professional man living in the same class the gain in this way may be more than outweighed by the increased cost of certain luxuries.

All these differences have to be taken into account in considering the normal effects of industrial competition; since, as we have seen,—quite apart from any obstacles to the mobility of labour—this does not necessarily tend to equalize money-wages, but only to get rid of any considerable and generally recognizable differences in the net advantages obtainable, on the average, by equally efficient and industrious labourers in the same industrial grade.

§ 7. The tendency to such equalization, however, is—as we have already noticed—still further limited by the existence of obstacles that impede the migration of labourers. These obstacles would still exist to a certain extent, even if the influence of mere inertia and easily removable ignorance, as well as the more definite hindrances to migration that have sometimes been interposed by law, and the barriers against intrusion sometimes raised by combinations of labourers¹, were altogether eliminated. There would always be a certain expense, trouble, and loss of time involved in transporting an individual—and still more a family—to a distant place; there would generally be a loss of indefinite advantages derivable from the kindly regard of neighbours, and a loss of useful knowledge of the special conditions of industrial and social life in a given locality—which would be greater if the change involved the learning of

¹ It should be observed that in other ways Trades' Unions tend to aid the mobility of labour from place to place; by developing habits of concerted action among labourers, elevating the average level of their intelligence, collecting and diffusing information as to rates of wages in different localities, &c.

a new language, or of new modes of work; and there might still be a general aversion to expatriation, and even to leaving familiar scenes and breaking social relations. If however, we suppose the distribution of industries and industrial population to remain without material change for a considerable time, these obstacles alone could hardly hold permanently in check the forces tending to equalization, at least within the same country—except in the case of a class of labourers so poor that the mere expense rendered migration impossible, without very severe privations; since the influences above-mentioned would not commonly affect strongly more than a part of the population of any district; and the prospect of higher wages elsewhere would continually attract the more migratory element—e.g. young unmarried or newly married persons of an enterprising turn of mind¹.

Such obstacles to migration affect the more highly-paid labourers, including the employers of labour and capital, in a less degree than others; and, though the greater part of capital already invested is, at best, far less mobile than labour, still, in an industrially advanced country, where wealth grows rapidly, floating capital tends to flow rapidly and in large volume into localities specially favourable for production. Hence, supposing no material change to take place in the local distribution of industries, the net advantages generally believed to be obtainable by the employment of equal amounts of new capital in different localities would before long be roughly equalised. This equalization would not, of course, affect rent or any extra profit analogous to rent, accruing on capital partially exempted by circumstances from competition. Such extra yields tend rather to become more unequal, as the concentration of labour and capital in certain places becomes more intense through the growth of population and the specialisation of industries.

¹ It is assumed in this argument that the average personal efficiency of labourers in the same industry is the same in different localities. The tendency to equalization is impeded, so far as the average efficiency in different places is different, even if the difference be such as is likely to be gradually removed by migration. An important case of this kind is the low average efficiency of labour in certain places which results from the very lowness of its remuneration causing an inadequate supply of the necessaries of healthy life.

We may conclude, in short, that under the influence of industrial competition, the special economic advantages attached to different localities, supposing them to remain substantially unaltered, would ultimately express themselves in the distribution of industrial incomes mainly in the form of rent or some extra yield similar to rent. But in fact such local advantages are continually undergoing changes so rapid and extensive, as to balance—or more than balance—during a considerable period, the equalizing forces of industrial competition. Sometimes (1) the extension of an industry already established in a certain district is so rapid, owing to the extension of the demand through improvements either in processes of manufacture or means of communication with other districts, or perhaps to a rise in demand in consequence of a change of social habits or industrial needs, that in spite of the continual increase in the supply of labour and capital employed in the industry, the remuneration of both labourers and employers continues for many years to remain at a scarcity height. (2) Sometimes again, the extension of our knowledge of localized natural resources, or the discovery of new means of obtaining or using materials already known, may alter importantly the relative advantages of different districts for a certain kind of production, so that large new centres of industry may be rapidly formed in new districts, and old ones deserted. The development of the cotton manufacture in Lancashire after the inventions of Arkwright and Watt is an instance of the former kind of change; the discoveries of new valuable mines most strikingly illustrate the latter.

The effects of such changes on other inhabitants of the districts in which they occur are complex, and vary somewhat according to the precise nature of the change and the conditions of the industry primarily affected. If these latter are such that an additional amount of produce cannot be obtained except at a higher cost, a rise in demand or improvement in communication that leads to a larger sale of the produce in question outside the district must *ceteris paribus* through the consequent rise in price inflict loss on all inhabitants of the district except the producers who gain by it. In the case of the products of manufactures—as distinct from those of agriculture and mining—this result is

not likely to occur, except very transiently; here, as we have before seen, increased production generally leads to greater cheapness. In all cases, however, the rise in the wages of labour in the industry primarily affected has a certain tendency to raise wages generally throughout the district; at the same time the flow of labour and capital to a district where a manufacturing or mining industry is growing tends to bring gain to other industries of the same district by increasing the local market for their products. Thus (e.g.) the development of a manufacture in a town, increasing its population and demand for food, tends to benefit the agricultural producers in the surrounding country. If, however, the products thus locally raised in price are easily transportable, and consequently the producers in the district are closely pressed by the competition of similar producers outside, they are not unlikely to lose more by the general rise in wages than they gain by the rise in demand for their commodities; in which case the capital invested in these other departments of production will be gradually reduced, and may even be withdrawn altogether. In this way the successful establishment of any one great centre of industry in any district has a tendency to promote indirectly the concentration of other industries in other localities.

On the other hand the development of one kind of production—say the production of cotton—in one district (A) in consequence of an increased sale of its products in another district (B), will be accompanied by a decline in the production of cotton or some similar product in B, unless the commodity that thus loses its market was previously obtained by B from some third place. This change will of course benefit the consumers of cotton in B, while causing temporary loss to a particular class of producers; and, in all ordinary cases, it will be ultimately a gain on the whole to the larger region including the two districts; since the labour that would otherwise have produced cotton may be employed more advantageously in some other way. But it should be observed that if the labour thus dispensed with is a considerable part of the whole labour of B, the probability that this new remunerative employment will be found within the limits of B is proportionately diminished. This point is not of great importance so long as A and B are

within the limits of the same country; but when, in the next book, we come to consider the arguments for perfect freedom of trade between different countries, we shall have to take note of the displacements of labour that, under certain circumstances, tend to accompany the development of such trade.

CHAPTER XII.

CUSTOM.

§ 1. IN the preceding chapters we have been endeavouring to ascertain the general way in which the Exchange values of material products and the remuneration of different classes concerned in industry would be determined in a society, whose members enjoy perfect freedom of contract and freedom in the choice of domicile and calling, and further possess the characteristic of always seeking to obtain for the commodity that they exchange the largest real return that they know to be obtainable—taking all kinds of gain and loss into account. It is only in respect of the assumed universal presence of this characteristic, not in the absence of any ordinary human impulses compatible with this, that the ideal individual to whom our economic deductions directly relate—the “economic man” as he has been called—should be conceived to differ from an ordinary member of a modern civilised community. That such a difference exists, to a not unimportant extent, has been incidentally noticed several times in the preceding chapters; but it seems desirable, before concluding this part of the treatise, to analyse its causes rather more fully than has yet been done.

The main part of these causes is, by many writers on Political Economy, designated broadly under the general term Custom. Mill, indeed, goes so far as to say that “under the rule of individual property, the division of the produce is the result of two determining agencies, Competition and Custom.” And if we leave Combination¹ and Governmental interference

¹ As I have before observed, Combination, though opposed to Competition as the term is ordinarily used, is not excluded by the fundamental assumptions of the theory of Competitive distribution.

out of account, and take Custom in a comprehensive sense, the assertion is approximately true: but it is important to distinguish the very different motives and economic forces whose operation is thus summed up, in order to ascertain clearly how far they can properly be said to conflict with competition.

In the first place the word Custom is commonly used to designate two quite distinct tendencies of human nature: the tendency to do what one has done before and the tendency to do as others do. Both these tendencies equally operate to prevent that continual modification of action in order to adapt it to the continual change of men's circumstances and opportunities, which is required to realize completely the greatest possible economy in production, and the scheme of distribution that economic science contemplates. Men continually get less for their money, goods or services, because they exchange them not in the best market but in the market they have been used to frequent; and they continually produce less than they might do by a given amount of labour, because they follow not the best methods that have been invented and published but the methods followed by their neighbours. At the same time each impulse has economic effects of very different kinds and blends with and is sustained by very various motives.

To obtain a clear view of these it will be well to denominate each of these tendencies separately. For convenience' sake we will speak of the former as *Habit*, and reserve the term *Custom* to the latter (though by the usage of language it is equally applicable to the former).

I will begin by noticing the obvious fact that both *Custom* and *Habit*, though they often interfere with an alert and vigilant pursuit of amelioration, are also to a great extent economically useful in saving time and labour. By doing what he has done before, or what others do, a man avoids the trouble of deciding anew on each occasion, where the advantage that can be gained by the best decision is not worth the time and trouble spent in making it. Hence the *Goodwill* of a business would remain a valuable possession, however intelligently all purchasers aimed at the maximum of economic gain in their purchases; especially if we add to the advantage of trouble saved, the further advantage which the purchaser of any commodity obtains through

fixed habits of dealing, in a general disposition of the seller with whom he deals to oblige him.

Next, in explaining the obstacles which Habit continually presents to the adoption of economic improvements, we must distinguish between the mere blind adhesion to an accustomed routine, and such rational aversion to the expenditure of labour and waste of acquired dexterity involved in learning new processes as would be felt by the most perfectly 'economic' man.

Further, so far as the breach of habit involved in a change of work or residence causes actual discomfort, it is possible that, on the strictest calculations of self-interest, this drawback may outweigh the pecuniary gain that would result from the adoption of the proposed change. The ties of mere association formed by a man's previous life, no less than the ties of social or patriotic affections, constitute an economic force operating to keep a man where he is, the action of which is in no way excluded by the fundamental assumptions on which the theory of competitive distribution proceeds.

Finally, it should be observed that a man's habits of dealing are frequently sustained, even when they have become economically disadvantageous to him, through his sympathy with the expectations that they have excited in the minds of others, and the disappointment that would be produced if they were discontinued. The tendency to do what one has hitherto done has its counterpart in the tendency to expect to be treated as one has hitherto been treated. Indeed, some claims generated in this way have legal validity; as when a right of way is established without express permission of the landowner, merely by his continued indulgence. And even in cases where such expectations obtain no legal protection, the breach of them, if the loss caused by it is considerable, is often felt to be a hardship, if not exactly an injustice; and consequently moral and sympathetic motives co-operate in preventing such a breach of habit. Perhaps the most conspicuous effect of these mingled motives is seen in the case of domestic servants; men continually endure a moderate, and not rarely a large, amount of incompetence in an old servant rather than inflict the hardship of dismissal; and that even when they do not feel any special affection for the person thus benefited.

§ 2. In the cases just mentioned the grievance is much greater, and the motives preventing divergence much stronger, when the *habitual* conduct has been also customary—in the sense in which we have distinguished this term from ‘habitual.’ Customs thus operating vary indefinitely in usage and duration: for instance, English landlords have often allowed their farms to be let at rents below the market rate, merely because their ancestors—perhaps only their fathers—did so before them. More widely-extended customs are often regarded as morally binding even where they do not carry with them any legal obligation. It is thought to be inequitable to refuse to pay a man what persons of his class usually receive for a given service, or, by taking advantage of special circumstances, to make him pay more than is ordinarily paid for any service that he receives. Indeed when a man speaks of “fair wages” for his work he often seems to mean no more than customary wages; and when he complains of being charged “extortionate” prices, he can only defend the epithet by an appeal to custom. How far such an appeal is founded on reason, we will hereafter consider: here we need only observe that even in the most economically advanced of existing communities, material divergences from purely competitive distribution are to be referred to Custom conscious or unconsciously determining notions of equity: while in other ages and countries the influence of this principle has predominated so much over that of Competition, as sometimes to reduce the operation of the latter within very narrow limits.

It is to be observed, however, that customs determining remuneration may be effective without assuming the dignity of moral rules. For instance the customary payment of fees for certain professional services—such as those of physicians and solicitors—is not, I think, supported by any general sense that the sums paid are just what the services in question are fairly worth. Rather, as I have already suggested, the effect of custom in such cases, at least in the existing condition of such a society as our own, blends with that of tacit combination, e.g. the fact that it is customary to pay a physician a guinea for his professional advice tends to produce a general acquiescence in the charge, which it is the interest of physicians generally to maintain and which it might not be quite so easy to gain for a

revised tariff of fees; and therefore unless physicians as a body form a decided opinion that their average earnings would be increased by a different charge, the existing custom is not likely to be disturbed. Still if it appeared to be clearly the interest of physicians as a class to raise or lower the customary fee, it can hardly be doubted that the union of the profession is sufficiently strong to impose such a change both on the public and on any recalcitrant members of their own body. We may say therefore that the existing fee is determined by custom, but under the condition of not differing materially from what would be determined by express combination.

Again, there are certain customs of expenditure which, without being morally obligatory, are yet supported by effective social sanctions; so that the breach of them is either certain or likely to be a bar to employment, or at any rate to success, in certain callings, or otherwise to entail pecuniary loss. The obligations thence arising are in part strictly professional—such, e.g. as the necessity of wearing a certain costume imposed on barristers, clergymen, waiters, &c.; partly, again, they are attached to the social grade from which the class of labourers in question is chiefly taken; thus a clerk would incur disfavour by wearing the dress of a mechanic; a physician would not succeed who did not appear to live in a style above that of an ordinary clerk; it is even considered a part of the duty of certain highly paid officials to give costly entertainments. So far as such customary expenditure is generally felt to be burdensome, it should not be regarded as a part of the spender's consumption, economically speaking; but rather as a part of the cost of production of his services, which will therefore tend to be returned to him in the remuneration received for them. If, however, the custom corresponds to—and is, in fact sustained by—the general tastes and inclinations of persons of the social grade from which the labourers in question are chiefly drawn, it will only tend to raise the wages of such labourers so far as it constitutes an additional obstacle to the competition of aspirants from the grade below.

In some cases, again, the neglect of received customs of expenditure would hardly either prevent a man from obtaining work of a particular kind, or detract from its pecuniary emolu-

ments; it would merely diminish his share of the social consideration that commonly attaches to these functions. This leads us to notice that the actual allotment of social rank to different callings itself depends to a great extent on the stability of custom; being often materially different from the allotment that might be expected to result from an intelligent consideration of the importance of different social functions, or of the qualities required for their efficient performance. At the same time this influence of custom, however irrational it may seem, is yet a motive force which an intelligent pursuer of private interest cannot disregard. For even if such a person were so exceptionally constituted as to derive no immediate satisfaction from social consideration, he could hardly fail to find it useful indirectly in various ways.

§ 3. It thus appears that only a part of the great and varied influence of custom can be regarded as a force opposed to competition and which the fuller development of the latter must necessarily diminish. So far as the maintenance of fixed habits of dealing, and rates of remuneration not frequently changed, leads to economy of time and labour, the development of competition has of course no tendency to modify it. So far, again, as custom determines the social consideration attaching to certain kinds of work, or imposes certain modes of outlay as a condition of obtaining such consideration, its effects should, I conceive, be treated merely as a part of the pre-existing social circumstances in which the laws of competitive distribution are supposed to operate. Customs in this latter sense may be altered, indeed are continually being altered to some extent, by the progress of civilisation; but the mere development, intensive and extensive, of the intelligent pursuit of private interest has not in itself any tendency to alter them. Nor, again, can we say that such development will necessarily tend to obliterate the effect of customs that fix the money-price of services, so far as they are really supported by a veiled or tacit combination of the persons to whom they are profitable; though it will probably tend to strip off the veil and render the combination open and avowed.

There remain two important and fundamentally different ways in which the influences of custom and habit undoubtedly

counteract, to some extent, the force of competition. Firstly, so far as the mere tendency to follow use and wont operates blindly, without consideration of the consequent gain and loss, its force combines with that of simple inertia and carelessness in diminishing—or, still more often, retarding—the changes in wages or prices, corresponding to changes in the conditions of industry, which competition tends to bring about¹. Secondly, so far as men's sense of Justice or Fairness is consciously or unconsciously determined by Custom, its influence may be considered as a part of the aggregate effect of moral or quasi-moral sentiments in modifying the competitive distribution of produce. Besides the sense of Justice—which, be it observed, has sometimes acted powerfully in a direction opposed to use and wont—we may note Patriotism, Philanthropy, Pity, Friendship, Religion and other forms of devotion to an ideal, as emotional forces that come in various ways into conflict with the desire of private gain. So far, indeed, as such motives merely induce men to devote income or time and energy to other purposes than those of private enjoyment, their effects need not be included among the phenomena with which economic science is concerned. Thus almsgiving of all kinds—extending the term to include all donations to individuals or public objects—may be considered as a secondary redistribution of wealth, valuable as supplementing the defects and mitigating the rigours of the primary competitive distribution, but not necessarily to be taken into account in economic reasonings. But in applying such reasonings to the facts of any particular community, we shall find a more or less extensive region in which no such sharp line between 'economic' and 'eleemosynary' expenditure of wealth or labour can be drawn, except by a rather useless fiction; since a considerable amount of the labour from which men obtain their livelihood is performed for remuneration less than might be earned in some work no more fatiguing or disagreeable, from a deliberate postponement of the labourer's pecuniary interests to other aims. I do not, however, propose here to

¹ It is solely to this diminution and retardation of the effects of competition by the mere *vis inertiae* of custom that I should be disposed to apply the metaphorical term "friction"; which some economists have used more vaguely and widely.

examine in detail the actual effects of these elevated sentiments in modifying the action of economic forces; any more than I propose to investigate systematically the actual economic effects of governmental interference, in England or other civilised communities at the present day. Both investigations are highly interesting and important; but to make them at all complete would necessitate the introduction of a larger amount of economic history, and of the general history of society, than the scope of the present treatise admits. I prefer, therefore, to confine what I shall say on either subject to such topics as may be most conveniently treated in connexion with the discussion, to which we are now to proceed, on the principles which ought to regulate the economic intervention of Government.

BOOK III.

CHAPTER I.

THE ART OF POLITICAL ECONOMY.

IN this third book of my treatise I propose to discuss briefly the principles of Political Economy considered as an Art, or department of the general Theory of Practice. It has been already observed¹, in the introductory portion of this work, that the "principles of Political Economy" are still most commonly understood, even in England, and in spite of many protests to the contrary, to be *practical* principles—rules of conduct public or private. This being so, it seems to me that confusion of thought on the subject is likely to be most effectually prevented, not by confining the Theory of Political Economy to economic *science* in the strictest sense—the study, whether by a positive or a hypothetical treatment, of the actually existing production and distribution of valuable commodities—but by marking and maintaining as clearly as possible the distinction between the points of view of the Science and the Art respectively, and the methods of reasoning appropriate to each.

How then shall we define the scope of Political Economy considered as an Art?

If we follow the indications of language, it would seem to be a branch or application of a more general art called 'Economy' without qualification. Another branch of this more comprehensive art is commonly recognised as "Domestic Economy" or "economy in household matters." Here the object with which the economist is concerned is wealth or money; but we equally speak of "economizing" time (or labour measured by time), economizing mechanical force, &c., &c.

¹ Introduction, c. II. § 1.

Comparing these different uses, we may define 'Economy' generally as the art or method of attaining the greatest possible amount of some desirable result for a given cost, or a given result for the least possible cost; 'cost' being of two kinds, either (1) the endurance of pain, discomfort, or something else undesirable, or (2) the sacrifice of something desirable, either as an end or a means¹.

The Art of Political Economy, then, would seem to be Economy applied to the attainment of some desirable result not for an individual but for a state or aggregate of states.

So far we may hope to avoid controversy. But when we go on to ask what the desirable result is which Political Economy seeks to realise, we find the question less easy to answer. It has already been noticed² that Adam Smith and his earlier successors, so far as they treated Political Economy as an Art, conceived its end to be that the national *production* of wealth should be as great as possible; and hardly appear to have entertained the notion of aiming at the best possible Distribution. But this limitation of view is hardly in accordance with the ordinary use of the wider term 'economy.' The idea of an economic *expenditure* of wealth, of which the aim is to make a given amount of wealth as useful as possible, is even more familiar than that of economic production of wealth: in fact Domestic Economy, as ordinarily understood, is simply the Art or Faculty of "making wealth go as far as possible." And it seems most in accordance with the received division of economic science, adopted in the present treatise, to recognise at least a possible Art of Distribution of which the aim is to apportion the produce among the members of the community so that the greatest amount of utility or satisfaction may be derived from it.

It may be said that this latter inquiry takes us beyond the limits that properly separate Political Economy from the

¹ I have before urged that labour is not necessarily to be regarded as something disagreeable; all that we can infer from the fact that any kind of labour has to be paid for is that some out of the whole number of persons required to furnish all the labour that society is prepared to purchase, *either* dislike this labour, or desire wealth obtainable by some other kind of labour more than they dislike that other kind.

² Introduction, c. II. § 4.

more comprehensive and more difficult art of general Politics ; since it inevitably carries us into a region of investigation in which we can no longer use the comparatively exact measurements of economic science, but only those far more vague and uncertain balancings of different quantities of happiness with which the politician has to content himself. But the discussions in Book I. on the definitions of wealth and value seemed to lead to the conclusion that the real exactness of economic as compared with ordinary political estimates is generally over-rated. For it there appeared that, though we could measure all wealth at the same time and place by the ordinary standard of exchange value, *i.e.* money, still in comparing amounts of wealth at different times and places neither this nor any equally exact standard was available ; and we were accordingly obliged to some extent to fall back on a necessarily more indefinite comparison of utilities. Since, then, even in the reasonings of economic science, an estimate of the utility of wealth is to some extent indispensable, no fundamental change of method is introduced by adopting this estimate more systematically in the present part of our investigation.

It may however be questioned whether, so far as we regulate the distribution of produce, we should do so on the principle that I have laid down as 'economic.' Many would urge that we ought to aim at realizing Justice or Equity in our distribution. Hence it seems desirable to examine the principles of Justice or Equity that have been proposed as supreme rules of distribution ; and, so far as any such principles approve themselves on examination, to consider how far their application would coincide with, and how far it would diverge from, the pursuit of the 'economic' ideal.

Meanwhile we may take the subject of Political Economy considered as an Art to include, besides the Theory of provision for governmental expenditure, (1) the Art of making the proportion of produce to population a maximum, taking generally as a measure the ordinary standard of exchange value, so far as it can be applied : and (2) the Art of rightly Distributing produce among members of the community, whether on any principle of Equity or Justice, or on the economic principle of making the whole produce as useful as possible.

Here, however, it may be asked, Whose conduct the Art is supposed to direct? and some further explanation on this point seems certainly to be required. First as regards Production—the term ‘Art of Production’ might be fairly understood to denote a systematic exposition of the rules, by conforming to which individuals engaged in industry may produce the maximum of commodity with the minimum of cost. But Political Economy is not usually supposed to include such an exposition; and it appears to me that it would be difficult to give any general instruction of this kind, if it is to be more than a collection of common-places, without entering more fully than would be convenient into the details of particular kinds of industry. At any rate I do not propose to attempt this in the present book; I shall follow tradition in treating as the main subject of Political Economy, regarded as an Art of Production, the action of Government for the improvement of the national production: but it seems desirable, for completeness, to include in our consideration the action of private persons for the same end, so far as it is not prompted by the ordinary motives of pecuniary self-interest or regulated on commercial principles. This extension of view is still more clearly called for in dealing with the Art of Distribution; where gratuitous labour and expenditure have, especially in modern times, largely supplemented the efforts of governments to mitigate the distressing inequalities in the distribution of produce, that are incidental to the existing competitive organisation of society.

Finally, I have to observe that, in defining the scope of the Art of Production, I have implied that the mere increase of population is not an end at which it aims. This is, I think, now the generally accepted view of political economists. A statesman, however, will generally desire, *ceteris paribus*, a large population for his country: and we shall find that some important kinds of governmental interference with industry—such as the regulation of land-tenure—have been partly advocated with a view to increase of population rather than of wealth. I propose therefore in one or two cases to consider the effects of governmental interference in relation to this end.

CHAPTER II.

THE SYSTEM OF NATURAL LIBERTY CONSIDERED IN RELATION TO PRODUCTION.

§ 1. ON the very threshold of the subject of enquiry defined in the preceding chapter we find ourselves confronted by the sweeping doctrine that the sole function of an ideal Government in relation to industry is simply to leave it alone. This view in some minds seems to be partly supported by a curious confusion of thought; the absence of governmental interference being assumed for simplicity's sake in the hypothetical reasonings, by which the values of products and services are deductively determined, is at the same time vaguely regarded as a conclusion established by such reasonings. Still it is true (as was before pointed out¹) that political economists since Adam Smith—to whom no such confusion of thought can reasonably be attributed—have commonly been advocates of *Laisser Faire*. And since this doctrine, so far as it is sound, is evidently the most important conclusion of Political Economy considered as an Art, it will be convenient to begin this department of our investigation by examining carefully the grounds on which it is advocated.

Throughout this examination it is desirable, for clearness' sake, to keep distinct the two points of view which we have taken separately in the two preceding books. For the proposition that what, after Adam Smith, I shall call "natural liberty" tends to the most economic production of wealth, by no means necessarily implies the further proposition that it also tends to the most economic or equitable distribution of

¹ Introduction, c. 2.

the aggregate produce. It has no doubt been commonly maintained by the more thorough-going disciples of Adam Smith in France and Germany,—of whom Bastiat may be taken as a type—that natural Liberty tends to realise natural Justice: and a similar view has been frequently expressed or implied in the utterances of subordinate members of the “Manchester School” in England. But I am not aware that it has been expressly maintained by any leading economic writer in England from Ricardo downwards; and since the influence of J. S. Mill has been predominant, I do not think it has been the prevailing opinion even among the rank and file of the “orthodox” school of Political Economy. Many, at any rate, of those who in England have held most strongly that it is expedient for Government to interfere as little as possible with the distribution of wealth resulting from free competition, have not maintained this on the ground that the existing inequalities are satisfactory; but rather in the belief that any such interference must tend to impair aggregate production more than it could increase the utility of the produce by a better distribution.

It will be convenient therefore to commence with an examination of the arguments by which the system of Natural Liberty is justified in its relation to production. The following is a concise statement of the reasoning to this conclusion which—though I do not know that it is anywhere very distinctly and completely stated—is implied, and more or less expressed, in numberless passages of the works of Adam Smith and his successors.

Assuming as universal an intelligent and alert pursuit of the interest of self and family, it is argued that wealth and other purchaseable commodities will be produced in the most economic way, if every member of society is left free to produce and transfer to others whatever utilities he can, on any terms that may be freely arranged.

For the regard for self-interest on the part of consumers, will lead always to the effectual demand of the things that are most useful; and regard for self-interest on the part of producers will lead to their production. That is, the production of each commodity will stop at the point at which an extra

quantum would be socially estimated as less useful than something else that could be produced at the same cost. The self-interest of producers will also lead to the production of everything at the least cost: for the self-interest of *entrepreneurs* will lead them to purchase services most cheaply, taking account of quality: and the self-interest of labourers—including its expansion, through parental affection, into *domestic interest*—will cause them to be trained to the performance of the best-paid, and therefore most useful, services for which they are, or are capable of becoming, adapted; so far as the cost of the training does not outweigh the increment of efficiency given by it. Any excess of labourers of any kind will be rapidly corrected by a fall in the demand for their services; and, in the same way, any deficiency will be rapidly made up. Thus the only thing required of government is to secure that every one shall really obtain the utility he buys, and shall have perfect freedom to sell what he can furnish.

This conception of the single force of self-interest, creating and keeping in true economic order the vast and complex fabric of social industry, is very fascinating; and it is not surprising that, in the first glow of the enthusiasm excited by its revelation, it should have been unhesitatingly accepted as presenting the ideal condition of social relations, and final goal of political progress. And I believe that the conception contains a very large element of truth: the motive of self-interest does work powerfully and continually in the manner above indicated; and the difficulty of finding any adequate substitute for it, either as an impulsive or as a regulating force, is an almost invincible obstacle in the way of reconstructing society on any but its present individualistic basis. At the same time, before we accept the system of natural liberty as supplying the type to which a practical politician should seek to approximate, it is important to obtain a clear view of the general qualifications with which the argument above given has to be accepted, and of the particular cases in which its optimistic conclusion is inadmissible.

§ 2. I propose, therefore, in the present chapter, to concentrate attention on these qualifications and exceptions. And, in so doing, I think it will be most instructive to adhere, in the

main, to the abstract deductive method of treatment which has been chiefly employed in the preceding book; since many persons who are willing to admit that the principle of *Laissez Faire* ought not to be applied unreservedly in the actual condition of human societies, yet seem to suppose it to be demonstrably right in the hypothetical community contemplated in deductive economics. This supposition appears to me seriously erroneous; hence in the present chapter I am specially concerned to show that even in a society composed solely of "economic men", the system of natural liberty would have, in certain respects and under certain conditions, no tendency to realise the beneficent results claimed for it¹.

I may begin by pointing out that the argument for *laissez faire* does not tend to show that the spontaneous combination of individuals pursuing self-interest will lead to the production of a maximum of *material* wealth, except so far as the individuals in question prefer material wealth to utilities not embodied in matter. So far as their choice falls on the latter—so far (*e.g.*) as the wealthier among them prefer the opera and the drama to the arts of painting and sculpture, and a greater abundance of servants, to a greater elaborateness in food, clothing, and ornaments—the result of their free action will be to render the production of material wealth less than it would otherwise be. And even taking 'produce', as I propose to do, in the wider sense in which it has been taken in the preceding

¹ It is from this point of view that Cairnes' interesting and persuasive essay on "Political Economy and Laissez Faire" (in his *Essays in Political Economy Theoretical and Applied*) appears to me most defective. Cairnes reaches the conclusion that *Laissez Faire*, though the safest "practical rule," yet "falls to the ground as a scientific doctrine," by pointing to actual shortcomings in the production and distribution of social utility, and tracing these to the mistaken notions that men form of their interests. But this reasoning seems to me palpably inconclusive, according to the view of Political Economy as a hypothetical science, which Cairnes elsewhere expounds (*Logical Method of Political Economy*, Lect. II). What on this view he has to prove is that there is any less reason for regarding *Laissez Faire* as a doctrine of this hypothetical science than there is for so regarding those deductive determinations of the values of products and services which might equally well be shown not to correspond exactly—nor, in all cases, even approximately—to the actual facts of existing societies. This, then, is the point to which I chiefly direct attention in the present chapter.

books, to include immaterial utilities as well as material, we have still to observe that men may prefer repose, leisure, reputation, &c., to any utilities whatever that they could obtain by labouring. Thus the freeing of a servile population may cause a large diminution of production (in the widest sense of the term); because the freedmen are content with what they can get by a much smaller amount of labour than their masters forced them to perform. In short 'natural liberty' can only tend to the production of maximum wealth, so far as this gives more satisfaction on the whole than any other employment of time.

The importance of both these qualifications becomes more clear when they are viewed in connexion with a third. In the abstract argument, by which the system of natural liberty is shown to lead to the most economic production, it has to be implicitly assumed that all the different parts of produce are to be measured, at any one time and place, by their exchange value¹. That is, we have to assume, that utilities valued highly by the rich are useful to the community in proportion either to their market price, or to the pecuniary gain foregone in order to obtain them. And among these utilities, as we have just seen, we must include the gratification of the love of power, the love of ease, and all the whims and fancies that are wont to take possession of the minds of persons whose income is far more than sufficient to satisfy ordinary human desires. It is only by this strained extension of the idea of social utility that the production of such utility under the system of natural liberty can be said to have even a general tendency to reach the maximum production possible. Thus, for instance, there is no reason why, even in a community of most perfectly economic men, a few wealthy landowners, fond of solitude, scenery or sport, should not find their interest in keeping from cultivation large tracts of land naturally fit for the plough or for pasture; or why large capitalists generally should not prefer to live on the interest of their capital, without producing personally any utilities whatsoever.

The waste of social resources that might result in this way

¹ A certain margin of uncertainty is introduced, so far as the interference of Government has any effect in altering Exchange-value. But this, for our present purposes, may be neglected.

is likely to be greater the nearer a man approaches the close of life, so far as we suppose self-interest to be his governing principle of action. Unless he is sympathetic enough to find his greatest happiness in beneficence, it may clearly be his interest, as his end draws near, to spend larger and larger sums on smaller and smaller enjoyments. So far, indeed, as a man has any descendants to inherit from him, it is perhaps legitimate to assume, as political economists generally do, that he will generally wish to keep at least his capital intact for the sake of his heirs; but it is difficult to see what ground there is for making any such assumption in the case of persons unmarried or childless. Such persons, again, even if they do not spend their accumulations on themselves, may (and not unfrequently do) make an almost equally uneconomical disposal of them by whimsical or ill-judged bequests. And this leads me to another difficulty that stands in the way of the consistent realization of the system of natural liberty, if extended to include freedom of bequest. Granting that men in general will extract most satisfaction out of their wealth for themselves, if they are allowed to choose freely the manner of spending it; it does not in any way follow that they will render it most productive of utility for those who are to come after them if they are allowed to bequeath it under any conditions that they choose. On the contrary, it rather follows that any such posthumous restraint on the use of bequeathed wealth will tend to make it less useful to the living, as it will interfere with their freedom in dealing with it. How far it would therefore be generally useful to impose restrictions on bequest is a question which can only be decided by a balance of conflicting considerations; we have to weigh the gain of utility that may be expected from the greater freedom of the heirs against the loss of utility that may be feared, not so much through the diminution in the satisfactions of the testator—which perhaps need not be highly estimated—but from his diminished inducement to produce and preserve wealth. But however this question may be decided, the theoretical dilemma in which the system of natural liberty is placed is none the less clear. The free play of self-interest can only be supposed to lead to a socially advantageous employment of wealth in old

age, if we assume that the old are keenly interested in the utilities that their wealth may furnish to those who succeed them: but if they have this keen interest, they will probably wish to regulate the employment of their wealth; while again in proportion as they attempt this regulation by will, they will diminish the freedom of their successors in dealing with the wealth that they bequeath; and therefore, according to the fundamental assumption of the system of natural liberty, will diminish the utility of this wealth to those successors. Of this difficulty there is, I think, no theoretical solution: it can only be settled by a rough practical compromise.

A somewhat similar difficulty arises in respect of the enforcement of contracts. If all contracts freely made are to be enforced, it is conceivable that a man may freely contract himself into slavery; it is even conceivable that a large mass of the population of a country might do this, in the poverty and distress caused by some wide-spreading calamity. In such a case Freedom of Contract would have produced a social state in which Freedom of Contract would be no longer allowed to large numbers, and therefore its effect in keeping production economic would be correspondingly restricted. It may be said that such contracts would not really be in the interest of the enslavers; and it is no doubt true, that according to the fundamental hypothesis that we are now considering, it cannot be *A*'s interest to make a contract with *B* which will tend to diminish *B*'s prospective utility to *A*, taking everything into account. It may, however, be possible for *A* to make a contract, which though it will tend to diminish *B*'s productive efficiency on the whole, will tend in a greater degree to increase *A*'s prospect of securing to himself the results of this efficiency: and, if so, *A*'s self-interest will clearly prompt to such a contract. It is quite possible, again, that the most valued utility which *B* can provide for *A* is the gratification of the love of power or superiority which *A* will obtain by a more complete control over *B*; so that it will be *A*'s interest to obtain this control at the cost of rendering *B*'s labour less productive—in any ordinary sense of this term.

On similar grounds it may not be *A*'s interest to expend wealth or labour in increasing the efficiency of *B*, even when

such outlay would be socially most remunerative, if it is either impossible, or at any rate a difficult and hazardous business, for *A* to appropriate an adequate share of the resulting increment of utility.

§ 3. This leads me to notice a specially important way in which the inequalities in Distribution—which natural liberty has no manifest tendency to diminish—may react unfavourably on Production. So far as the most economic production involves present outlay for remote results, it may be prevented by the fact that the persons concerned do not possess and cannot procure the requisite capital. In the preceding book we have been led to observe how the poverty of the masses tends to cause the services of the higher grades of skilled labour, including the labour of large employers, to be *paid* more highly than would be the case if wealth were more equally distributed. But this result is also *prima facie* evidence that such services are *rendered* less abundantly than would be the case if the labour and capital of the community were most productively employed; since it may be inferred that society would purchase an additional increment of such services at a price more than sufficient to repay the outlay necessary to provide them,—while at the same time it would not be profitable for any one else to provide the money, with the view of being repaid out of the salary of the labourer educated; not only on account of the jural difficulty of making contracts with children, but because—even if this difficulty were overcome—the interest required to compensate for the trouble and risk of the deferred payments would be practically prohibitive. In this way it may be profitable for the community to provide technical and professional education at a cheap rate, even when it would not be profitable for any private individual to do this.

The above is only one of a large and varied class of cases in which private interest cannot be relied upon as a sufficient stimulus to the performance of the most socially useful services, because such services are incapable of being appropriated by those who produce them or who would otherwise be willing to purchase them. For instance, it may easily happen that the benefits of a well-placed lighthouse must be largely enjoyed by ships on which no toll could be conveniently im-

posed. So again if it is economically advantageous to a nation to keep up forests, on account of their beneficial effects in moderating and equalizing rainfall¹, the advantage is one which private enterprise has no tendency to provide; since no one could appropriate and sell improvements in climate. Scientific discoveries, again, however ultimately profitable to industry, have not generally speaking a market value on the same ground: the inventions in which the discovery is applied can be protected by patents; but the extent to which any given discovery will aid invention is mostly so uncertain, that even if the secret of a law of nature could be conveniently kept, it would not be worth an inventor's while to buy it, in the hope of being able to make something of it.

An important case that comes under this head is that of Protection to native Industry, so far as this is hypothetically justifiable in abstract economic reasoning. Such protection, of course, so long as it continues necessary, imposes an extra tax on the consumers of the article protected. But there are conceivable cases in which the loss to a country thus caused might be compensated by the ultimate economic gain accruing from the domestic production of a commodity now imported; while yet the initial outlay, required to establish the industry without protection, would not be likely to be compensated to the private capitalists that undertook it. This would be the case if the need of the outlay were of such a kind that when once adequately met by the original *entrepreneur*, it would no longer exist for others or would exist in a much less degree: since (in that case), almost as soon as the industry began to be profitable, competition would tend to reduce profits again, bringing prices to a point at which they would be remunerative to the later comers, but not to the introducer of the industry who had borne the initial sacrifices.

There are other cases again, in which there would be no difficulty in appropriating and selling a commodity, but in which the waste of time, trouble, and expense involved in such sale would render it on the whole a less economical arrangement for the community than the alternative of providing the com-

¹ Cf. Ran-Wagner, *Finanzwissenschaft*, 1^{ter} Theil, § 193.

modity out of public funds. For instance, this is likely to be the case with much frequented roads, such as streets and bridges in a town.

§ 4. On the other hand, private enterprise may sometimes be socially uneconomical because the undertaker is able to appropriate not *less* but *more* than the whole net gain of his enterprise to the community; for he may be able to appropriate the main part of the gain of a change causing both gain and loss, while the concomitant loss falls entirely upon others. Thus a company *A* having made an expensive permanent instrument—say a railway—to the advantage both of themselves and of their fellow-citizens, it may be the interest of another company *B* to make a new railway somewhat more convenient for the majority of travellers—and so likely to draw the lion's share of traffic from *A*—even if the increment of utility to the community is outweighed by the extra cost of the new railway; since *B* will get paid not merely for this increment of utility, but also for a large part of the utility that *A* before supplied.

This last instance leads us to notice another case in which the most enlightened private enterprise has no general tendency to produce a maximum of social utility. The private producer may be in the position of a monopolist; and, therefore, as we have before seen, his interest may diverge materially from that of the community; since he may increase his maximum net profit by restricting his supply of his commodity to an amount considerably less than the maximum that could be remuneratively produced and sold. At the same time, though a monopoly in private hands is thus economically dangerous, there is in certain cases a decided economic gain to be obtained by that organization of a whole department of production under a single management, which inevitably leads to monopoly; either because the qualities required in the product are such as unity of management is peculiarly qualified to provide—as in the case of the medium of exchange—or merely from the saving of labour and capital that it renders possible. And it may be observed that cases of this kind tend to increase in number and importance, as civilisation progresses and the arts of industry become more elaborate. Thus the aggregation of human beings into large

towns has rendered it economically important that the provision of water for the aggregate should be under one management; and the substitution of gas for candles and oil-lamps has had a similar economic effect on the provision of light.

The practical importance of the conflict of private and social interests just mentioned is much increased by the extent to which total or partial monopoly may be effected by Combination¹—especially when we consider that it may be the interest of the combining producers not only to limit the amount of the utilities that they produce, in order to raise their price, but also to resist any economies in production which may tend to decrease the demand for them². It should be observed that wherever payment is not by results, it may easily be the interest of any individual labourer *in any particular job*, to extend uneconomically the amount of labour required, or to give as little work as he can in the time (supposing that harder work would be more irksome). But it is only where some combination of labourers exists, or custom partially sustained by combination, that it can be any one's interest *on the whole* to do this; since if the price of his services were settled by open competition, a labourer so acting would lower the market value of his services.

§ 5. But even apart from combination, avowed or tacit, and without any deliberate effort on the part of individuals to make their labour less useful in order that more of it may be required, it is quite possible that open competition may cause a similar uneconomical effect, while fulfilling its normal function of equalizing the remuneration of producers. For suppose that the services of any particular class of labourers receive on the average a disproportionately high remuneration as compared with those of other classes; there are two ways in

¹ Combination is no doubt often tacitly excluded in the reasoning by which it is argued that the most economic production tends to result from the play of individual self-interests. But I do not see how it is legitimately to be excluded.

² It is one of the most serious of economic objections alleged against Trades' unions, from the point of view of the community, that the regulations of some of them are partly framed to carry out this anti-social method of increasing the remuneration of a particular class. How far this allegation is true I do not wish to decide. Cf. Thornton on *Labour*, Pt. iii, c. 5, and Howell, *Capital and Labour*, c. viii.

which this excess can be reduced, either (1) by lowering the price of a given quantum of the utilities produced by the workers in question, or (2) by increasing the number of persons competing to produce such utilities, without augmenting their aggregate produce, owing to the increased difficulty that each has in finding customers. So far as this latter result takes place, the effect of competition on production is positively disadvantageous. In actual experience this effect seems to occur most conspicuously in the case of services of which the purchasers are somewhat deficient in commercial keenness and activity; so that each producer thinks himself likely to gain more on the whole by keeping up the price of his services, rather than by lowering it to attract custom. An example of this kind is furnished by retail trade, especially the retail trade of the smaller shops to which the poorer class chiefly resorts; since the remarkable success of the cooperative stores of artisans implies a considerable waste of shopkeepers' time and labour under the system previously universal. Still even in a community of thoroughly intelligent and alert persons, the practical advantages of established good-will or business connexion would still remain: the economic man would find it his interest under ordinary circumstances, for saving of time and trouble, to form and maintain fixed habits of dealing with certain persons. There would always be many dealers who would be trying to form, and had as yet imperfectly succeeded in forming, such connexions. Thus it appears that a considerable percentage of unemployed or half-employed labour is a necessary concomitant of that active competition for business by which industry is self-organised under the system of natural liberty: and the greater the fluctuations of demand and supply, the greater is likely to be this percentage of waste.

A somewhat similar waste, of labour and capital employed in manufactures, &c., due to the difficulty of adapting supply to an imperfectly known and varying demand, has been noticed in the last chapter but one of the preceding book, in discussing the phenomenon of (so-called) "over-production."

.. But again; the importance to each individual of finding purchasers for his commodity also leads to a further waste

socially speaking, in the expenditure incurred for the sole purpose of attaining this result. A large part of the cost of advertisements, of agents and "travellers," of attractive shop-fronts, &c., come under this head. A similar waste, similarly incident to the individualistic organisation of industry, is involved in the initial expenses of forming joint-stock companies, in the case of undertakings too large for ordinary private capitalists—expenses which could not be avoided, even in a community of economic men, though the skilled labour required for launching such companies would not be remunerated quite so largely as it is here and now.

§ 6. Hitherto we have not made any distinction between the interests of living men and those of remote generations. But if we are examining the merits and demerits of the purely individualistic or competitive organisation of society from the point of view of universal humanity, it should be observed that it does not necessarily provide to an adequate extent for utilities distant in time. It was shown before that an outlay of capital that would be useful to the community may not be made because it would be unremunerative to individuals at the only rate at which they could (owing to poverty, &c.) borrow the money. But we may go further and urge that an outlay which would be on the whole advantageous, if the interests of future generations are considered¹ as much as those of the present may not be profitable for any individual at the current rate at which wealth can be commercially borrowed.

This may be merely because the return is too distant; since an average man's interest in his heirs is not sufficient to make him buy a very long deferred annuity, even if its price be calculated strictly according to the market-rate of interest. But, speaking more generally, I do not see how it can be argued from the point of view of the community that the current interest, the current price that individuals have to be paid for postponing consumption, is the exact condition that has to be fulfilled to make such postponement desirable; though

¹ There is no abstract reason why the interest of future generations should be less considered than that of the now existing human beings; allowance being made for the greater uncertainty that the benefits intended for the former will actually reach them and actually be benefits.

of course it is a condition inevitably exacted in a society of economic men organised on a purely individualistic basis.

§ 7. So far I have left unquestioned the assumption—fundamental in the system of natural liberty—that individuals are the best judges of the commodities that they require, and of the sources from which they should be obtained, provided that no wilful deception¹ is practised; as I have thought it important to make quite clear that, *even if this assumption be granted*, what may be called the ‘scientific ideal’ of economists—the political conditions of industry which they assume in abstract reasoning with a view to the explanation of economic phenomena—cannot legitimately be taken as the practical ideal of the Art of Political Economy; since it is shown by the same kind of abstract reasoning to be liable to fail, in various ways and to an indefinite extent, of realizing the most economical and effective organisation of industry. It may perhaps seem that these results are of merely speculative interest; since all but a few fanatics admit that the beings for whom complete *laissez faire* is adapted are at any rate not the members of any existing community. But I venture to think that the theoretical conclusion above reached has considerable, though indirect, practical importance. If it were demonstrable only from blind adhesion to custom and habit, or from want of adequate enlightenment, that the concurrence of self-interests could not actually be relied upon to produce the best aggregate result for the community, at any rate the direction of social progress would seem to be fixed and the goal clearly in view; the pace at which we ought to try to advance towards complete *laissez faire* would still be open to dispute, but the sense that every diminution of governmental interference was a step in the right direction, would be a strong inducement to take the step, if the immediate effects of taking it appeared to be mixed, and the balance of good and evil doubtful; while optimistic persons would be continually urging society to suffer a little present loss for the sake of the progress gained towards the

¹ The prevention of such deception is included in the functions attributed to government by the extremest advocates of *Laissez Faire*; though, as we shall see in the next chapter, it is a disputed question how far government should be allowed to interfere even for this preventive purpose.

individualistic ideal. But if, as I have tried to show, this is not the case; if on the contrary in an ideal community where the members generally were duly enlightened and alert in the pursuit of their interests, it might still be in various cases and on various grounds desirable to supplement or correct the defects of private enterprise by the action of the community in its collective capacity,—we shall view in a somewhat different light the practical questions of the present time as to the nature and limits of governmental interference. That is, in any case where the present inadequacy of *laissez faire* is admitted or strongly maintained, we shall examine carefully whether its defects are due to want of general enlightenment, or rather to one or other of the causes discussed in this chapter; and in the latter case shall regard governmental interference as not merely a temporary resource, but possibly a normal element of the organisation of industry.

It does not of course follow that wherever *laissez faire* falls short governmental interference is expedient; since the inevitable drawbacks and disadvantages of the latter may, in any particular case, be worse than the shortcomings of private industry. These drawbacks depend in part on such political considerations as lie beyond the scope of the present discussion, and vary very much with the constitution of the government in question, and the state of political morality in the country governed. Of this kind are (1) the danger of increasing the power and influence capable of being used by government for corrupt purposes, if we add to the valuable appointments at its disposal; (2) the danger, on the other hand, that the exercise of its economic functions will be hampered and perverted by the desire to gratify influential sections of the community—certain manufacturers, certain landlords, certain classes of manual labourers, or the inhabitants of certain localities; (3) the danger, again, of wasteful expenditure under the influence of popular sentiment—since the mass of a people, however impatient of taxation, are liable to be insufficiently conscious of the importance of thrift in all the details of national expenditure. Then, further, there is the danger of overburdening the governmental machinery with work—which can hardly be altogether removed, though it may be partly obviated, by

careful organisation; since the central and supreme organ of government must exercise a certain supervision over all subordinate departments, and every increase in the variety and complexity of the latter must make this supervision somewhat more laborious and difficult.

Other disadvantages, in part economic, in part purely political, attach to particular modes of governmental interference. Thus when the action of government requires funds raised by taxation, we have to reckon—besides the financial cost of collection and any loss to production caused by particular taxes—the political danger of adding to a burden already impatiently borne; where, again, it requires the prohibition of private industry, we must regard as an item on the wrong side of the account not only the immediate irksomeness of restraint, but the repression of energy and self-help that tends to follow from it; where, on the other hand, the interference takes the form of regulations imposed on private businesses, in addition to any detrimental effects on industrial processes that may inevitably accompany the observance of such regulations we may often have to calculate on a certain amount of economic and political evils due to successful or unsuccessful attempts to evade them.

And, lastly, in all cases, the work of government has to be done by persons who—even with the best arrangements for effective supervision and promotion by merit—can have only a part of the stimulus to energetic industry that the independent worker feels, who may reasonably hope to gain by any well-directed extra exertion, intellectual or muscular, and must fear to lose by any indolence or neglect. The same, however, may be said of the hired labour used by private employers, to an extent which the development of industry has hitherto continually tended to increase; including even the specially important labour of management, in the case of businesses conducted by joint-stock companies. And, on the other hand, government can apply certain kinds of stimulus which private employers have either not at their command at all, or only in a less degree; it can reward conspicuous merit by honours and distinctions, and offer to faithful service a more complete security of continuous employment and provision for old age. Still the loss, in govern-

mental service, of the enterprise and effort that is stimulated and sustained by a fuller sense of self-dependence, must be set down as very serious ; and, on the whole, there seems no doubt that even where the defects of *laissez faire* are palpable and grave, they may still be outweighed by the various disadvantages incident to governmental management of industry.

But, even so, it is important to observe, first, that these disadvantages are largely such as moral and political progress may be expected to diminish ; so that even where we do not regard the intervention of government as at present desirable, we may yet look forward to it, and perhaps prepare the way for it. And, secondly, even where we reject governmental interference, we may yet recognise the expediency of supplementing or limiting in some way or other the results of private enterprise : we may point out a place for philanthropic effort—as in the case of educational foundations ; or for associations of consumers to supply their needs otherwise than by the competition of independent producers—as in the case of the highly successful cooperative stores managed by artisans.

§ 8. What has been said above would be true, however fully it is granted that social progress is carrying us towards a condition in which the assumption, that the consumer is a better judge than government of the commodities that he requires and of the source from which they may be best obtained, will be sufficiently true for all practical purposes. But it seems to me very doubtful whether this can be granted ; since in some important respects the tendencies of social development seem to be rather in an opposite direction. As the appliances of life become more elaborate and complicated through the progress of invention, it is only according to the general law of division of labour to suppose that an average man's ability to judge of the adaptation of means to ends, even as regards the satisfaction of his everyday needs, is likely to become continually less. No doubt an ideally intelligent person would under these circumstances be always duly aware of his own ignorance, and would take the advice of experts. But it seems not unlikely that the need of such advice, and the difficulty of finding the right advisers, may increase more markedly than the average consciousness of such need and difficulty, at any rate where the benefits to be obtained

or the evils to be warded off are somewhat remote and uncertain; especially when we consider that the self-interest of producers will in many cases lead them to offer commodities that *seem* rather than *are* useful, if the difference between seeming and reality is likely to escape notice.

How far Government can usefully attempt to remedy these shortcomings of self-help must of course be doubtful, for the reasons discussed in the preceding section. We may, however, notice one important class of cases where the aid of Government is especially likely to be effective, and where the coercion either of law, or of the social sanction wielded by a deliberate and vigorous combination, is *prima facie* indispensable, except in a perfectly ideal community of economic men. I refer to the cases in which a certain rule of conduct is recognized as expedient for all members of the community—or all of a certain class—if all adopt it, but not otherwise; while at the same time its adoption by a majority renders it decidedly the *immediate* interest of individuals to break through it. The observance of the Sunday holiday by traders may be taken as an example of this class, supposing it were not sustained by traditional custom and religious sentiment, but had to be introduced *de novo* from a mere conviction of its advantages. However firmly all were convinced that the gain, even economically speaking, of a weekly day of rest universally observed would outweigh the inconveniences of the weekly interruption of business, still these inconveniences would be so seriously felt that any individual could gain valuable custom by violating the rule; so that except in a community where every one could rely completely on the intelligence and foresight of every one else, the general observance of the rule could hardly be introduced without the intervention of law, or of an express convention supported by strong social sanctions.

To sum up: the general presumption derived from abstract economic reasoning is not in favour of leaving industry altogether to private enterprise, in any community that can usefully be taken even as an ideal for the guidance of practical statesmanship; but is on the contrary in favour of supplementing and controlling such enterprise in various ways by the collective action of the community. The general principles on which the

nature and extent of such collective action should be determined have been given in the present chapter; but it would hardly be possible to work out a system of detailed practical rules on the basis of these principles, by the abstract deductive method here adopted; owing to the extent to which the construction of such system ought reasonably to be influenced by the particular social and political conditions of the country and time for which it is framed. In passing therefore from abstract principles to their concrete applications—so far as the limits of my treatise allow me to discuss the latter—it seems best to adopt a more empirical treatment: the exposition of which will be more conveniently reserved for another chapter.

CHAPTER III.

THE RELATIONS OF GOVERNMENT TO INDUSTRY.

§ 1. IN the chapter that follows this I propose to discuss some of the chief cases of Governmental intervention to benefit production which form a part of the policy and practice of civilised communities at the present day: not with the view of deciding dogmatically how far such interferences are right in any particular case; but rather in order to examine the general principles on which they are—or may be—maintained, and to see how far they illustrate the general exceptions to the sufficiency of Natural Liberty which we have just been considering from an abstract point of view.

But before proceeding to this examination, it seems desirable to obtain a somewhat clearer demarcation of its range: since there are many cases of Governmental interference with private industry, where the increase of production is not the primary aim, and where, accordingly, considerations as to *productional* effects cannot be put forward as decisive, though they must always be allowed some weight. It is, indeed, not always easy to decide whether a particular governmental measure or institution is to be classed as interference for Production or for Distribution, or for some other of the ends for which Government exists; since different reasons are given for it by different persons, among which the Government is not called upon to make a formal selection. Thus even in cases like those of the Poor-law and Elementary Education in England, in which, *primâ facie*, the interference is *distributional*—that is, in which pecuniary sacrifices are exacted from one part of the community for the benefit of another part,—arguments are earnestly used

to show that the persons taxed gain indirectly private advantages of some sort, worth purchasing at the price that they are compelled to pay. Thus the provision for the poor is maintained to be a fairly cheap insurance against the additional danger of crime, private and public, that is to be apprehended from persons rendered desperate by starvation: and similarly, elementary education has been advocated as a protection against crime, and also as tending to make the labour of the persons educated more useful to others. I do not mean to say that either the Poor-rate or the Education-rate is mainly maintained by the force of arguments such as these; but they have probably had considerable effect in enabling humane adherents of the system of natural liberty to shut their eyes to the socialistic aspects of these measures.

Still, notwithstanding the difficulty just pointed out, it is important to draw as clear a distinction as possible between measures designed to remedy the economic defects of natural liberty, and those of which the primary end is the maintenance or promotion of other elements of social well-being: and especially to distinguish the former from such action on the part of Government as is either inevitably involved in the exercise of those indispensable functions which even the most thoroughgoing advocates of *laissez faire* attribute to the state, or at any rate adopted with a view to the efficient performance of these functions. These latter interventions, I conceive, we should regard as lying either beyond the scope of our present investigation, or on the ambiguous confines separating the special Art of Political Economy from the wider Art of Politics¹. It is, indeed, difficult to over-rate the general importance of executing efficiently the necessary functions of Government, for the economic prosperity of the community governed; but the exact nature and limits of this indispensable work have to be considered in relation to social well-being generally, and not merely in relation to the most economic production of purchaseable commodities. I propose, therefore, in the present chapter, to take a brief survey of the

¹ As will presently appear, I allot to this border-ground the chief questions raised as to the limits of governmental intervention for the protection of property and the enforcement of contract.

normal action of Government in relation to private industry in order to exhibit the complex difficulty of distinguishing what we may call strictly *economic* interferences, and at the same time to make the distinction as clear as we conveniently can.

§ 2. Government, by those who restrict its sphere most rigorously, is still generally admitted to have the following duties; which are sometimes called its "necessary" as distinguished from its "optional" functions.

1. Protection of the interests of the community generally, and individual citizens so far as may be necessary, from the attacks of foreign enemies.

2. Protection of individual citizens from physical injury, insult, constraint, or damage to reputation, caused by the action of individuals.

3. Protection of property from detriment caused by others whether intentionally or through neglect; which involves the function of determining doubtful points as to the *extent* and *content* of the Right of Property and the modes of legally acquiring it.

4. Enforcement of contracts made by adults in full possession of their reasoning faculties, and not obtained by coercion or misrepresentation, nor injurious to other persons.

5. Protection of persons unfit, through age or mental disorder, to take care of their own interest. Of this kind of protection the most important case is that of children; and here it should be observed that the protection may be either direct, or indirect through

6. Regulation of the relation of the sexes, so far at least as to make generally adequate provision for the care and nurture of children.

7. To these may be added the function of self-support by taxation or otherwise, and so far as necessary self-defence against individuals. The limits of such self-defence have always been drawn with special care in free countries, and therefore form the subject of an important chapter in the Theory of Constitutional Law; but the discussion of them does not come within the scope of the present treatise. On the other hand, the theory of the provision for governmental expenditure, by taxation or otherwise, constitutes the

chief part of the art of Political Economy in the view of most economists since Adam Smith; and I accordingly propose to deal with it in a separate chapter¹.

We may begin by observing that the interference of Government with private industry, for whatever purposes, may be exercised in different ways. Thus, apart from (1) interference by direct prohibition or command—which may, of course, vary indefinitely in gravity—the Government may (2) indirectly prevent or discourage certain kinds of contract by refusing to enforce them; or (3) it may give to the obligations involved in certain common kinds of agreements, such as Sale and Purchase, Letting and Hiring, &c., a precise definition, interpretation, or presumption, which will be held to be valid in all cases where there is no special contract to the contrary; or again (4) certain kinds of business may be undertaken by the State, though at the same time it may remain open to private individuals or joint-stock companies to enter into competition with the governmental agency if they choose. In this latter case the only element of compulsion consists in the coercive levying (by taxation) of funds required for carrying on the business in question: and where the business can be made to pay its own expenses, even this element of coercion vanishes.

Which (if any) of these different modes of interference should be adopted in any particular case is a question which cannot be entirely decided by economic considerations. Even where the more intense interference by direct prohibition or command is both cheaper and more effective, a statesman may reasonably decline to employ it from fear of the displeasure and discontent which it is likely to cause; while, again, the probable amount of displeasure and discontent varies greatly with the actual state of custom and opinion in any particular community. And it should be observed that the magnitude of different kinds of interference will be very differently estimated, according as we take a political or an economic point of view. Thus, politically speaking, interference is at its

¹ Chap. VIII. It should be observed, however, that fiscal considerations necessarily enter into the discussion of certain kinds of governmental interference, designed mainly for other purposes.

minimum, when government, without any legal prohibition or restriction of private industry, merely prevents its development in a certain direction, by taking some new kind of business—such as the construction and management of railways—entirely into its own hands. But, economically considered, this interference is greater than when government places private businesses under legal control and regulation; since in the latter case some of the effects—good or bad—of private enterprise are retained, whereas by the former method they are altogether excluded.

§ 3. Let us now consider briefly the economic bearings of the action of government in the fulfilment of the indispensable functions above enumerated. Under the first head, of Defence against Foreign enemies, the most important economic questions—if we pass over the abnormal and violent disturbances of production and exchange which actual war may render needful or expedient—relate chiefly to the best way of securing an adequate supply of the personal services, materials, or instruments required for war; and will therefore be more fitly discussed later, when we come to treat of the theory of the provision for national wants. Here I would only point out that the needs of war may furnish decisive considerations in favour of measures which would otherwise be inexpedient—although they are not unlikely to be advocated on other than military grounds. Thus a government may reasonably undertake for military reasons the construction of railways commercially unremunerative; or may control the arrangement of a system of railways which it would otherwise leave to unrestricted private enterprise. Again, similar reasons have often been urged for the protection of native industry in certain departments; and certainly, where there is a reasonable probability that a government would find serious difficulty in obtaining, should it be involved in war, any part of the supply of men or things required for the efficient conduct of the war, it is obvious that some kind of provision should be made in time of peace for meeting this difficulty: and we cannot say *a priori* how far it will in any particular case be better to meet it directly, by a more extensive and costly organisation of the army or navy, or indirectly by the encouragement of certain branches of private industry. Thus,

for instance, it may be questioned whether Adam Smith was right in commending the English Navigation Laws of his time which "endeavoured to give the sailors and shipping of Great Britain the monopoly of the trade of their own country;" but the question cannot be answered without a careful investigation of details. The restrictions thus imposed on trade must of course have increased the cost of foreign commodities to the English consumers; but they may nevertheless have been the least burdensome mode of securing a due supply of sailors and shipping for our maritime wars. On similar grounds we cannot say positively that it can never be expedient for a country situated as England is to secure itself by protection to native agriculture against the danger of having its necessary supply of food cut off by a maritime blockade.

§ 4. It is, however, of more general importance to consider the various kinds of the interference with industry which may be necessary or expedient for the due protection of the life, health, physical comfort, freedom and reputation of individuals from harm inflicted, intentionally or otherwise, by private persons. It does not fall within the scope of this treatise to enter at any length into the controversy as to the proper limits of this interference: but we may distinguish as the two questions chiefly disputed (1) how far (if at all) government ought to interfere to prevent harm inflicted on any individual either by himself or with his own consent; and (2) how far it may legitimately go in preventing acts that are not directly or necessarily harmful, on the ground that they are likely in some indirect way to have harmful consequences to other persons besides the agent. These two questions are in practice closely connected; since in most cases where a man harms himself so seriously as to suggest a need of governmental interference, he also indirectly harms others: but, viewed abstractly, they are of course, quite distinct. The second question would be generally admitted to be one of degree: and it does not appear to me that the answer to it in concrete cases can reasonably be decided by any broad general formula¹: but

¹ For instance, I do not see on what grounds it can be maintained that "it is not a merely constructive or presumptive injury to others which will justify

rather that every case must be dealt with on its own merits, after carefully weighing the advantages and drawbacks of intervention. On the other hand, the former kind of interference seems undeniably opposed to the fundamental principle that every man is the best judge of what contributes to his own happiness, on which (as we have seen) the economic rule of *laissez faire* is commonly supported; on this principle each individual ought to set his own value on life and health, and to choose freely the means of maintaining them, just as much as in the case of other things commonly esteemed and sought as good. Actually, however, modern civilised governments have always conceived themselves justified in punishing attempts at self-destruction, and also in interfering in various ways to prevent serious injury to life or health, even when the risk of such injury would be voluntarily incurred, for gain or enjoyment¹: and the range within which such interference is called for, on empirical grounds, has been largely increased by the extensive use of dangerous machinery in modern industry. And here again I am of opinion that the expediency of such interference in any particular case can only be decided by the light of experience after a careful balance of conflicting considerations.

In some cases the burden is so trifling that no one would hesitate to impose it, if experience shows it to be at all efficacious for the attainment of either of the ends above distinguished. Of this kind are the regulations that printers' and publishers' names should be affixed to published documents, in order to secure punishment or redress in case of libels; that poisons when sold should be manifestly designated as such; that vehicles should carry a light at night, &c. But actually, in our own legislation, a considerable amount of more serious interference with the production or sale of certain commodities is maintained, in order to protect from disease and other physical damage either the persons voluntarily purchasing such commodities, or the persons engaged in making them, or other members of the

"the interference of the law with individual freedom" (Mill, *On Liberty*, c. 4). It appears to me that, on utilitarian principles, all we can say is that the presumption must be strong enough to outweigh the direct and indirect mischief of coercion.

¹ E.g. by prohibiting dangerous pastimes and exhibitions.

community. Thus regulations are made to secure that the lucrative occupations of physician, surgeon, apothecary and chemist shall only be carried on by properly qualified persons; restrictions are placed on the manufacture and carriage of explosive substances, and on the sale of stimulants that affect the reason and temper and thus tend indirectly to cause crimes of violence. In disturbed states of society the sale of fire-arms has frequently been prohibited; and, in other countries, gunpowder and saltpetre have been monopolized by government. So again, in industries exposed to special dangers—whether for the labourers only or for other persons also—such as mining, navigation, chimney-sweeping, our government endeavours in various ways to secure that proper precautions are taken against these dangers; partly by regulation of processes, partly by inspection of instruments, partly by the exclusion of all but properly qualified persons from the performance of certain functions, partly by the invalidation of contracts tending to diminish the protection given in these other ways¹.

In considering how far such intervention is expedient, any expense, trouble, or loss of utility caused by the action of government forms, of course, an item to be taken into account; at the same time we can hardly say that the decision of such points falls mainly within the sphere of Political Economy or is to be arrived at by strictly economic methods; taking the received view that life and health are goods which it is not possible to estimate at a definite pecuniary value².

And the same may be said of the interference of government for the protection of children, whether directly, as by limiting the amount of labour that may be exacted from them, and securing to them a certain amount of education; or indirectly by placing restrictions on the labour of married women (or women who have borne children) so far as these appear necessary in order to secure the proper performance of their

¹ Thus a merchant-seaman cannot deprive himself of the right to sue the ship-owner, in case the latter does not take all proper means for securing the sea-worthiness of the ship.

² I say "definite," because all reasonable persons would admit that at a certain point the machinery for saving even life and health may become too costly; and therefore the practical necessity of balancing these goods in some way against wealth cannot be evaded.

maternal functions. As the system of Natural Liberty is, even by its most vehement advocates, regarded as only applicable to adults, it is not in any way opposed to the principle of such regulations; and though the immediate economic loss caused by such restrictions, and the ultimate economic gain to the community from the improved health and training of its children, are important considerations in determining the nature and extent of this kind of interference, they are not by themselves decisive.

§ 5. In close analogy to the regulations above noticed that indirectly protect the person, stands another class of governmental interferences which have for their object the indirect prevention of theft. Of this kind are the regulations that hamper the easy disposition of stolen goods; such as the English law that a dealer in old metal may not at one time buy less than certain minimum quantities of lead, copper, tin, &c., and some of the restrictions imposed on pawnbrokers. With these, again, we may class regulations that aim at the indirect prevention of fraud in exchanges; such as the prescription of standard weights and measures, and the more recent prohibition of 'truck' (that is, of the payment of wages otherwise than in money),—so far as this is designed to secure to labourers the amount of real wages that is by contract fairly due to them. If we could extend the notion of 'fraud' to include all cases in which one of the parties to an agreement 'imposes' upon the ignorance of the other, several other important interferences with industry might be brought under this head; such as the regulations enforced on joint-stock companies—whether imposed to protect the interests of the individual members of such companies against their directors, or to protect other persons who may deal with them—the taxing of solicitors' bills, and some of the regulations of the business of carrying emigrants.

It is to be observed, however, that the element of active misrepresentation is not necessarily present in all cases of what is commonly called 'imposition.' In fact, the notion of 'imposition' affords us a transition, by which we gradually pass from exchanges in which positive deception is practised to exchanges which are merely held to be inequitable through the ignorance on one side of the quality of the article exchanged,

even though there may be no fraud or active misrepresentation on the other side, and no implied contract or general understanding that the other party will furnish the knowledge that is wanting. Now, in ordinary buying and selling, a purchaser is expected to protect himself against loss incurred under these latter conditions; and though experience may show that the intervention of Government to protect him is in certain cases urgently required, it must be allowed that such intervention is hardly consistent with the fundamental assumption of the system of natural liberty, that the sane adult individual is likely to be a better judge of his own interests than his government is. At any rate we may say that at this point we approach the rather delicate theoretical line that separates governmental action for the *maintenance* of real freedom of contract—which is impaired by successful fraud—from action that *invades* this freedom. Various regulations tending to prevent contracts from being made under misapprehension as to material circumstances may be regarded as lying on this debatable margin: such as the rules of law obliging vendors with special opportunities of knowledge—e.g. vendors of land and promoters of joint-stock companies—to disclose any material circumstances affecting the value of what they offer for sale: or again, the compulsory registration of contracts like mortgages or bills of sale, which are liable to render the real financial position of one of the parties to the contract so materially different from his apparent position that third persons dealing with him are in danger of being seriously misled.

A somewhat similar margin presents itself when we try to define the other main condition required for the validity of contracts according to the principles of natural liberty: viz. that they should not have been procured by coercion—that is, if we extend the notion of coercion to include not merely physical injury or constraint, but also the moral pressure which is sometimes called ‘undue influence’¹. It is, of course, in accordance with the strictest limitation of the sphere of government that it should prohibit and invalidate agreements procured by the

¹ The term ‘undue influence’ is also used to denote what I have previously called ‘imposition.’

infliction or threat of any illegal harm; and further, if in any case one party to a contract is able to cause pain or alarm of a kind which the law does not generally attempt to prevent, but which is not likely to be inflicted or threatened except as an inducement to make the contract, a special interference to prevent such undue pressure may fairly be regarded as a mere defence of freedom. Thus the special protection given by our law to merchant seamen, by the invalidation of contracts alienating part of their claims to wages, may be justified by the special opportunities of undue influence which the needful discipline of a ship gives to its master. So, again, the restrictions placed on the labour of women generally, in the English factory legislation, are commonly and plausibly defended on the ground that women, owing to their normal domestic dependence, require to be protected against the undue influence of the men with whom they live. When, however, the law interferes to prevent a contract in which *A* merely 'takes advantage of the distress' of *B*, without being in any way responsible for it—or, otherwise, when the pressure which *A* puts on *B* is merely the threat of not rendering some service which he is in no way bound to render independently of the contract—it seems plain that such interference must be viewed not as a protection of freedom of contract, but as a limitation of it in the interests of disadvantageously placed members of the community.

I have spoken of the enforcement of contracts voluntarily entered into as a kind of protection to freedom: and there can be no doubt that a refusal to enforce such contracts is an interference with the spontaneous organisation of industry which the system of natural liberty contemplates; in which enforcement of contract is the one elementary process by the repetition and complication of which the whole fabric is bound together. At the same time there is certainly something paradoxical in calling the refusal of government to enforce certain contracts, altogether or in part, an 'interference' with the freedom of the individuals left alone: and it is probably for this reason that the very important restrictions, by which the enforcement of contract has actually been limited, have not commonly been treated as violations of *laissez faire*. Thus in

England hardly any engagement to render personal services gives the promisee a legal claim to more than pecuniary damages;—to put it otherwise, almost all such contracts, if unfulfilled, turn into mere debts of money so far as their legal force goes. And it should be added that even the payment of debts is to a very large extent not exacted, even from persons who are now perfectly able to pay them; provided that at some previous time such persons have proved their inability to pay, given up their property for division among their creditors, and thus obtained as bankrupts protection against any future exaction of past debts. This very important limitation of the effects of contract is, I conceive, mainly to be justified as tending to promote the interests of production; being designed to restore to the bankrupt the stimulus to useful industry which an indefinite prolongation of his pecuniary liabilities would take away from all but the most energetic minds. It is thought that this can be done without any material sacrifice of the interests of creditors; since the latter, even if their claims were kept legally valid, would still have no effective means of compelling the defaulting debtor to earn the money required to satisfy them. It may be observed, however, that the same line of reasoning that thus justifies the general principle of a bankruptcy law also shows us that this kind of interference may easily be carried too far for the real interests of industry. For—even assuming that the details of such a law can be contrived and administered so as to prevent waste of the bankrupt's estate, secure its equal division among the creditors, and adequately punish not only common dishonesty on the bankrupt's part, but also such reckless and improper dealing with his borrowed resources as substantially amounts to dishonesty,—the danger still remains that the prospect of relief through bankruptcy may tempt men to run risks with borrowed property which they would not think it expedient to run with their own; and which, therefore, it is the interest of the community to prevent, although such dealing may not admit of being proved to be criminally reckless. And further, granting that a bankrupt should be exempt from legal obligation to pay his creditors in full, it still seems right that society should emphatically recognise the superior morality of the bankrupt who does pay them, so far as circumstances

enable him. To attain this end, and at the same time reduce the danger before-mentioned, it seems desirable to impose on the bankrupt certain disabilities which would not seriously interfere with his earning an honest livelihood, while yet they would express the coldness that society should feel towards a man who has failed to satisfy just claims—coldness rising to disapproval if he makes no effort to satisfy them. Thus the bankrupt—so long as his debts remain unpaid—should, I think, be deprived of all political franchises, and his name should be kept in a register open to the inspection of all persons in the place in which he trades. This latter provision, indeed, seems expedient on a different ground, of which we have before taken note: viz. for the due information of all persons who may hereafter have dealings with the bankrupt.

I have distinguished as a special mode of governmental interference that which operates by giving a definite interpretation to customary engagements. Here again a line requires to be carefully drawn between an impartial effort to ascertain and define the probable meaning of the contracting parties,—which is obviously an indispensable function of the judicature in case of disputes—and an attempt to modify what is held to be a bad custom; especially since in the development of our own “judge-made” law, the latter attempt has often been made in the guise of the former. Such interference by mere interpretation, which will only be operative if the persons affected do not bar it by express contract, is obviously of the very lowest degree of intensity, politically speaking, and hardly amounts to a sensible restriction on liberty; and it cannot be effective if the persons concerned are decidedly averse to the change sought to be introduced; but where there is no such aversion it may sometimes have important economic effects by overcoming the “friction” of mere carelessness and ignorance, or by forcing the tacit combination of persons who gain by the old bad custom to become open and aggressive, and so pointing it out for successful resistance.

This interpretative or quasi-interpretative intervention of law has been largely extended to the implied contracts or understandings involved in different economic relations. Thus the Law of Partnership and the Law of Agency largely consist of

definitions or interpretations of this kind, designed to prevent the disappointment of normal expectations. So far as such legal definition of rights and obligations merely imposes on the persons concerned the necessity of making express contracts and announcements, if they wish to avoid the obligations that the law defines as normal, it does not materially restrict natural liberty; it is only where this avoidance is not allowed, that the restriction becomes palpable and serious. For instance, the legal obligation on common carriers to receive the goods of all applicants on similar terms is merely an interpretation of a common understanding, if it can be evaded by giving full public notice; but if it cannot be so evaded, it becomes a material interference with *laissez faire*.

§ 6. Similar delicate questions as to the line to be drawn between the intervention of Government to protect, and its interference to control, the freedom of individuals, arise when we try to determine exactly the limits of the right of property according to the system of natural liberty. Granting that the natural right of property includes the power of absolutely excluding others from the use and enjoyment of any material thing over which the right has been acquired, it still remains to be asked what kinds of things natural liberty would allow to be thus appropriated—how far, in particular, it should be allowed with regard to land, the great permanent instrument and store of material for human industry. The extremest advocates of *laissez faire* have never disputed either the justice or the expediency of keeping in common ownership certain portions of land obviously more useful when freely used in common—such as roads, rivers, and other portions required for communication and conveyance. Further, in modern European countries even such land as has been allowed to pass completely into private ownership has been held liable to special burdens to public purposes; and the right of the community to take from individuals land specially needed for important public objects, at a price corresponding to the market value that it would have had independently of such special need—which in recent times has been generally admitted and to some extent exercised in the important case of railways—may perhaps fairly be regarded not as an encroachment on private ownership, but as a reservation tacitly understood when

such ownership was allowed. Again, so far as a community owns land as yet unappropriated, but likely to be more useful if allowed to pass into private ownership, it is a difficult and subtle question to determine whether the principles of natural liberty prescribe any one method of effecting this transition rather than any other: and whether any of the various complicated and elaborate regulations of the sale of public land which in English and other colonies have been adopted or proposed with a view to improve the process of colonization can properly be regarded as species of governmental interference¹.

A different kind of problem has somewhat perplexed and divided the adherents of natural liberty in respect of property in the results of intellectual labour. On the one hand it has seemed clear that the man who works with his brain has as much right to have the fruits of his labour secured to him as the man who works with his hands. On the other hand since the only effective way of protecting such fruits is to prohibit imitation on the part of others, it is not surprising that this very exceptional interference with the freedom of action of those others should have been thought by some persons to conflict with the principles of natural liberty. In the case of copyright, however, this latter view appears to me superficial; so far at least as the protection is limited to results which persons other than the author protected could not conceivably have produced by independent effort—as is mainly the case with copyright. It can hardly be an interference with *A*'s natural liberty to exclude him, in the interest of *B*, from the gratuitous use of utilities which he could not possibly have enjoyed except as a result of *B*'s labour. Hence I should be disposed to regard any limitation of copyright to a period falling short of the author's life², as a distinct encroachment on natural liberty in the interests of the community. But I should hesitate to take a similar view in the case of patents; since here the difficulty of preventing the protection of *A* from interfering with the independent action of *B* seems practically insuperable. It is almost always within the limits of human probability that in protecting a techni-

¹ Cf. *post*, ch. iv. § 11.

² As I shall presently point out, the right to control any kind of property after death is a doubtful point in the system of natural liberty.

cal invention we may be suppressing the possibility of a similar invention which might otherwise have been made by some one else; indeed such coincidence of inventions may even be said to be positively probable, whenever several ingenious minds are simultaneously pondering over the best method of meeting some definite technical need. Owing to this inevitable danger of conflicting claims, and to the undeniable hampering of industrial progress that is consequently liable to result from the protection of the first inventor, it seems hardly possible to frame the regulations of a patent law on any other principle than that of carefully balancing opposite expediencies. Indeed some able men who are not generally socialistic in their views, nor in any way opposed to the principle of copyright, have yet thought it best on the whole to do away with patents altogether, and to leave inventors to be rewarded by the state. While the majority of competent judges, who consider it practically impossible to give the inventor sufficient inducement to work except by securing him a legal monopoly of the results of his labour, are yet generally of opinion that the duration of this monopoly should be limited to a comparatively short term of years, in the interests of industrial progress: and many of them think it further desirable that a patentee should be compelled to allow his invention to be used by others, at a price fixed by government, under certain circumstances; that is, either (1) when the patentee does not use the invention himself, or (2) when any other inventor has made substantial improvements in it.

Another doubtful point in the definition of the rights of private property, on the principles of *laissez faire*, relates to the right of bequest. Many even among the jurists of an earlier age, in which the hypothesis of a Law of Nature was generally accepted, preferred to treat the right of bequest as established by Positive rather than Natural law; and in fact it is difficult to maintain that we interfere with a man's natural liberty by not letting his wishes determine the relations of other men to a material world in which he is no longer living. There are, indeed, two obvious and forcible reasons for allowing free bequest in a general way, independently of the actual sentiment in its favour; first, that any law prohibiting it would be likely to be frustrated by gifts before death; and secondly, that such

a law, so far as effective, would tend to diminish seriously the inducements to productive labour and care during the closing period of a man's life. But arguments of this kind can hardly be pressed to prove the inexpediency of *all* restrictions on freedom of bequest; and any such restrictions that tend to increase the utility of the wealth bequeathed by enlarging the freedom of action of those to whose management it is left, may fairly be advocated in the name of Natural Liberty, no less than in the interests of production. And in fact the tendency of modern English legislation has been to introduce, to a continually greater extent, two different kinds of limitations on the individual's right of disposing of his property after death; first in the case of bequests for public purposes, by treating the testator's dispositions as liable to an indefinite amount of revision and modification in the interests of the public, after a certain interval of time has elapsed; and secondly, in the case of private bequests, by restricting the testator's power of preventing the alienation of the property bequeathed, on the ground that such inalienable ownership is liable to lead to inferior management, especially in the case of land.

Again, since through accident, neglect or indecision a certain number of persons die without exercising the right of bequest, the government has the strictly necessary function of determining in such cases the devolution of the property left behind. *Ceteris paribus* the obvious end to be aimed at in distributing such intestate inheritances is to satisfy as far as possible any definite expectations which the general habits of bequest may have created: but the guidance of this principle is liable to be obscure and ambiguous, even on fundamental points: and even where it is not so, it cannot be regarded as an interference with natural liberty to deviate from the ordinary customs of bequest, in order to adopt an economically preferable rule of distribution—as (e.g.) by abolishing the law of primogeniture in a country where it is found to have an unfavourable effect on agriculture.

In short; neither "protection to property" nor "enforcement of contract" turn out to be in practice the simple matters that some theorists appear to suppose them. The determination of substantive or primary rights under either of these heads

involves disputed questions of great moment, in the settlement of which the effects of different rules on the production of wealth have to be carefully considered; and further questions of hardly less importance arise in the regulation of procedure and penalties, especially in respect of enforcement of contract—c.g. as to the nature of the penalties for non-payment of debt, and the order of priority in claims to be allowed to different classes of creditors. The consideration of economic consequences should in my opinion be generally paramount in deciding important issues in these departments of law: as for instance in determining the law of Bankruptcy, the law of Patents, and the main restrictions on Bequest. Since, however, this view has not generally been taken by jurists and legislators, it has seemed to me best to treat these questions as lying on a kind of debateable border-ground where the Art of Political Economy merges in the wider Art of Politics.

CHAPTER IV.

IMPORTANT CASES OF GOVERNMENTAL INTERFERENCE TO PROMOTE PRODUCTION.

§ 1. I NOW pass to the discussion of the chief actual cases in which modern governments have distinctly encroached on the system of *laissez faire* in the interests of production, either by taking into their own management certain departments of industry, or by regulating or assisting the undertakings of private individuals or companies. I ought to premise that in speaking of 'governments' I include both "central" and "local" or "provincial" governments and do not generally take note of the division of functions between the two kinds of organs. If my limits allowed, it would be interesting to discuss the economic considerations that have to be taken into account in determining this division. We might notice in the first place the analogy between the general arguments for or against centralisation of governmental functions and the arguments for "large-scale" and "small-scale" production in private industry: in either case we have to balance the advantages of more special experience in managers and more keen concern for details of the result, against the advantages of more systematic management and generally more comprehensive views and a higher quality of skill. Again, for governmental work in which particular districts are solely or mainly interested, it is natural to select the local governments of such districts; on the other hand, care has sometimes to be taken that the local government does not exercise its functions in the interest of its locality where that is opposed to the interest of the whole country—e.g. if a single town or district has the management of an important railroad or waterway, it may be tempted to make the greatest

net profit out of its monopoly by a rate of charge inconveniently high for the rest of the community. These and other general considerations might be illustrated under more than one of the heads that we are about to discuss; but on the whole I have thought it best to avoid all questions relating to the *structure* of government, and confine myself to the determination of its economic functions.

If we put on one side (1) the promotion of Education and Culture, which it would be paradoxical to treat simply, or even mainly, from a productional point of view, and (2) the 'burning question' of protection to native industry,—which I reserve for a separate chapter,—we find that the departments of production with which governments have actually concerned themselves are chiefly various branches of what may be called the machinery of transfer; including under this term, not only Conveyance and Communication—the establishment and management of roads and bridges, canals and railroads, harbours and lighthouses, the organisation for sending letters and telegrams, &c.—but also the machinery of Exchange; i.e. the issue of metallic and paper currency, and the business of banking so far as it is connected with currency. The universality of the need of the commodities furnished by these various businesses has been sometimes put forward as the justification for governmental intervention; it has been said that the provision for such commodities, being a matter of common concern, is properly undertaken or controlled by the community through its government. But, on reflection, this reason can hardly be maintained as conclusive; since the needs of food, fuel, clothing, and shelter—the provision for which is almost universally left to private enterprise in modern communities—are even more urgent and universal than the needs of conveyance and communication: and, again, this reason would not explain why governments should so largely leave the provision for the moveable instruments of conveyance—carriages, ships, &c.—to private enterprise, while undertaking the establishment of the permanent and stationary instruments—roads, canals, harbours, &c.

It would rather seem that the chief arguments for governmental interference in these departments are, *firstly*, that organisation on a very large scale—and in some cases organisation

under a single control—is either necessary or obviously most expedient in important parts of the businesses concerned with transfer; so that if they were left to private enterprise, either (a) some important utilities would not be provided at all, or would be more expensive or inferior in quality; or (b) the business of providing them would become the monopoly of private persons, whose interest would not generally coincide with the interest of the public. *Secondly*, there is a special probability that the advantage to the public of improvements in the machinery of transfer may exceed very greatly the direct utilities to the persons who primarily benefit by them; which latter are generally the only utilities for which the provider is able to obtain remuneration in the way of free exchange.

There are besides certain special drawbacks or obstacles incident to the production of some of these commodities by private enterprise, which will appear when we consider some of the businesses in detail.

§ 2. *Ordinary Roads.* Both the above reasons for governmental intervention apply forcibly to the case of ordinary road-making. The indirect advantages derived from good roads, both in the improved organisation of national industry which results from the development of internal trade, and in the general spread of intelligence, are universally recognised; while yet the utilities of transit, as estimated by the individuals who would purchase them, would not be sufficient to enable private undertakers to construct remuneratively the less frequented roads—at any rate if the land had to be bought—: so that to make the road system of a modern civilised community as complete as is on public grounds to be desired, the intervention of Government—central or local—would seem to be almost indispensable. On the other hand, the more frequented roads which it would undoubtedly be profitable to construct, would always be in the condition of partial monopoly; and therefore there would be no general probability that it would be most profitable for the monopolist owners of the roads to charge such a price for their use, or to keep them in such a condition, as would afford the maximum of public utility. The monopoly, no doubt, would always be partly controlled by the fear that excessive tolls or gross neglect would lead to the construction of a new road; but if the new road were

less convenient to the majority of those who used it, and were therefore liable to be at any time abandoned in favour of the old road if the charges and condition of the two were equalised, its construction would be too hazardous an undertaking to be easily entered upon.

Further, we have to observe that the use of roads managed by private enterprise must necessarily be sold; and the expense and inconvenience involved in this transaction is a serious drawback in the case of much frequented roads. In the extreme case of the streets of a town no one would propose that the expenses of construction or maintenance should be defrayed by tolls; and this arrangement is now regarded as being on the whole undesirable in the case of highways generally—in spite of its obvious equity from the point of view of distribution.

The question, however, whether ordinary roads should be generally managed by private enterprise has never been a practical one; chiefly because the portions of the earth's surface now employed for this purpose, have, to a great extent, been used in common from time immemorial, and so have remained the property of the community using them, while the rest of the land has gradually passed into private ownership.

In England, when the importance of keeping the roads themselves in good condition came, in the 18th century, to be more fully recognised, the expenses were at first defrayed by tolls, the management being what may be called *quasi-governmental*¹: but the expense and inconvenience of collecting tolls has led to the gradual abolition of this system, and the defrayment of expenses out of the rates. The bridges that form part of roads have for the most part been similarly dealt with; in a few special cases, such as the bridges over the Thames, the construction has been undertaken by private enterprise on the security of tolls; but even these have, for the most part, been subsequently bought up by public bodies.

¹ I refer to the system of "turnpike trusts," by which the management of different turnpike roads was placed in the hands of different bodies of trustees, partly public and partly private, who obtained private capital on loan, paying the interest with the proceeds of the tolls, but derived no personal profit from the business.

§ 3. *Canals and railways.* The case is otherwise with canals and railways. Many of these more artificial and elaborate ways of communication have been constructed and managed by private enterprise. Still in some of these cases the funds for their construction have been partly obtained by the aid of Government, in the form of a guarantee of interest or otherwise; while even where the capital of railways has been raised without any assistance from the national exchequer, the companies providing it—in fully peopled countries¹—have usually had to obtain from Government exceptional powers for the compulsory purchase of land, in return for which they have had to submit to a certain amount of governmental regulation. In many other cases railways and canals have been altogether constructed at the public expense, and managed by Government officials. The actual motive for these various kinds and degrees of governmental intervention has generally been that otherwise it did not seem likely that the improvements in question would be executed at all; the prospect of profit to private undertakers not being sufficiently brilliant and certain to overcome the difficulty of collecting capitals of the large amount required. In the case of railways in particular, the power of compulsory purchase of land has almost always been found indispensable; without it, the most enterprising companies would have shrunk from the task of bargaining with a large number of private landowners, each able by his refusal to increase the expense and diminish the utility of the line very materially. The practical issue has therefore not been between private enterprise pure and simple, and any form of governmental interference, but merely as to the kind and degree of the latter. For, on the very principles of natural liberty, it is due to the owners of property on whom a forced exchange is imposed, that the power to compel such exchange should only be granted after careful investigation has shown a decided prospect of public advantage from it; while yet the necessity of making this investigation, by whatever machinery it is conducted, renders it difficult to exclude altogether the kind of illegitimate influences that we before noted as a danger incident to governmental

¹ In the United States and the Dominion of Canada, the construction of great railways has been subvented by large grants of land as yet unoccupied.

management¹. So again, when a railway has been constructed, the more or less complete monopoly which it is sure to have of the facilities of conveyance between certain places on its line is, in part at least, due to the necessity of obtaining governmental sanction for any rival undertaking; hence Government is specially called upon to take care, if possible, that the interests of the public are not sacrificed to those of the monopolists. Further, the large amount of capital required for the construction of a railway or a canal, generally excludes the independent enterprise of individual capitalists from this department: the choice, therefore, lies practically between (1) governmental agency and (2) the agency, under governmental control and regulation, of large joint-stock companies; and we have before observed that the latter is likely to exhibit somewhat the same defects as governmental agency, in comparison with management by private employers. The experience of different European countries, during the last fifty years has afforded considerable means of comparing the two systems: and the drawbacks that it has shown to exist in the system of management by regulated joint-stock companies may be stated as follows—taking for simplicity the case of railways, which has now the greatest practical importance.

1. In *Construction*, want of system, leading to unnecessary outlay; while yet gaps are left which it would be for the interest of the community to fill up; since local lines not likely to bring additional profit to shareholders might often pay their own expenses and greatly benefit their districts.

2. In respect of *Management*, again, so long as the separate companies are fighting each other for traffic, the public loses by the incoherent organization of its railroads—through difficulties of through-booking and imperfect correspondence—probably more than it gains in cheapness by competition. Competition, however, tends to be continually reduced by the ‘Fusion’ or ‘Amalgamation’ of companies, which it is decidedly the interest of the latter to effect;—though until it is effected the desire that each company naturally has to arrange the amalgamation on

¹ It may be added that the English system of quasi-litigious investigation by pleadings before Parliamentary Committees introduces an important new item of cost into the original outlay.

the best terms to itself tends to intensify rivalry, and prevent any effective cooperation in the meanwhile.

3. Amalgamation, however, increases the danger of divergence between public and private interests, that we have seen to be involved in monopoly. Nor has anything been gained, in England, by the attempt made to secure the public interest, when the construction of the line is authorized, by imposing limits on the fares charged; and attempts of this kind seem generally likely to fail, since the difficulty of forecasting the future conditions of a business like railway travelling would render it necessary to fix the limits of charges at the outset so high that it would probably not be the interest of the companies to come up to it, in case the undertaking was successful.

Again, any attempt to keep down the profits of such a monopoly, by fixing a maximum dividend, is open to grave economic objections; since when the maximum is reached, the company ceases to have any interest in preventing waste in management. In England, however, the profits of railways have not as yet reached a very high figure: here the actual divergence of private from public interest lies rather in the fact that the former excludes the possibility of such a reduction of fares as might greatly increase the utility of the railways at the risk of a *slight* loss in net revenue—a risk which it would obviously be expedient for the community to run under the circumstances, but not for private shareholders.

On the other hand, in a country like our own, in which large accumulations of capital are continually being made, and any opening for its profitable employment is eagerly seized, there are great counterbalancing advantages in leaving the field to joint-stock companies: and there seems no reason to doubt that this agency has actually supplied us with railways both more amply and at an earlier period than governmental agency would have done, and probably with a closer adaptation of the order in time of their construction to the needs of industry.

On the whole the conclusion would seem to be, in the case of undertakings of this kind, that where the work is likely to be done by joint-stock companies if Government does not interfere, it should be left to the former during the first and more tentative stage of the undertaking, and even that private enterprise

should be encouraged by concessions tolerably liberal as to charges, &c. for a limited period; but that the ultimate interests of the community should be secured by giving the Government the right of either (1) freely revising the charges at the end of the period, or (2) taking the business entirely into its management, on the payment of a fair price for the material capital employed, but without any extra sum in consideration of actual or expected profits¹.

In the case of railways it is not practically possible to separate the general management of the machinery of conveyance from the management of the roads over which it works². But, as I have before observed, the case is different with ordinary roads and canals. Here the provision and management of the moveable instruments of conveyance has been generally left to private enterprise, without any governmental control for economic purposes, except as regards the prices charged for the use of vehicles plying in the streets of towns. The ground for this latter exception lies in the great convenience to the consumer of a uniform and stable price: otherwise the use of hackney carriages would seem to be a commodity of which the value might be left to be determined by open competition, as advantageously as the value of any other article.

§ 4. *The Post-Office, &c.* The conveyance of letters is the department in which the advantages and success of governmental interference are most generally admitted—with the exception, perhaps, of coinage. The reason is that, while the business is in the main of a routine kind, adapted to governmental agency, both the gain in convenience and the saving of labour secured by unity of management is specially great: since the cost of carrying letters from office to office is but slightly increased by any increase in their number, while the reduction in the ratio of labour to utility in the work of distribution, obtained by the monopoly of it within each area of distribution, is very considerable. The saving through unity of management is less (*a*) in

¹ As I shall presently point out, the same principles are applicable to other businesses besides those connected with transfer, provided they are of a kind that tend to become monopolies.

² When railways were first introduced, it was intended that the use of them should be made available to the carriages of private individuals.

the case of bulky or heavy parcels, since each additional parcel tends materially to increase the aggregate of carriage; but when a national machinery exists for the distribution of letters and light parcels, there seems a clear advantage in using it also for the distribution of larger parcels.

Before I pass to consider the other department of what I have called the machinery of transfer—viz. exchange—it may be convenient to notice a case of governmental interference which does not come under this head, but which in other respects has important economic affinities to the case of railways: I mean the provision of light and water. The analogy consists in the fact that these commodities have to be brought to the consumers by means of a special kind of path (pipes, wires), which can only be constructed by obtaining the partial use of long strips of land; these must either (1) be public roads (as is ordinarily the case), or (2) be obtained by compulsory sale: so that in either case some degree of governmental interference would be indispensable. Further, the expense of constructing any such special paths of conveyance, in a town or any thickly inhabited district, would be to a great extent the same whether the consumers supplied by it were all the inhabitants of the district in question or only a scattered portion of them; hence the saving of cost obtained by keeping the whole supply of a certain area under one management is so great as to render a practical monopoly manifestly the most economic arrangement. On these grounds it is generally agreed that unrestricted competition, though it may be transiently useful, is not to be regarded as the normal condition of these branches of production: the issue is rather between governmental *regulation* and governmental *management*, and is to be decided, I conceive, in much the same way as the similar issue in the case of railways.

§ 5. *Metallic Currency.* The claims of the State to the monopoly of coining have been so generally admitted that the most uncompromising advocates of *laissez faire* have rarely thought it needful even to explain why they have not questioned it¹: however, the abstract economic reasons for it may

¹ So far as I know, Mr Herbert Spencer is the only writer of repute on this side, who has seriously proposed to leave the business of coining to private enterprise. I may observe that Mr Jevons in replying to Mr Spencer's arguments

be stated as follows. In the first place the ordinary advantage to the community from competition, in the way of improving processes of manufacture, is hardly to be looked for in the case of coin. It is the interest of the community that coins should be as far as possible hard to imitate, hard to tamper with, and qualified to resist wear and tear; but the person who procured the coins from the manufacturer—who would want, of course, to pass the money, and not to keep it—would be prompted by no motive of self-interest to aim at securing excellence in these points.

Secondly, the admitted governmental duty of giving protection against fraud would under any circumstances have to be performed with special vigilance in the case of coin, owing to the extremely transitory interest that each individual has in the quality of the money he uses; and though this might conceivably be managed, if free coinage were allowed—by making it criminal to issue coins of the kind ordinarily used, containing less than the ordinary weight of metal—still the prevention of fraud would be far more difficult than it is at present, when all coining is illegal and all coins of the same value uniform in shape.

A supplementary argument in favour of governmental coining—in the abstract¹—lies in the difficulty of otherwise securing a fair allotment of the loss through wear and tear of standard² coins. The convenience of circulation would in any case lead to the establishment—by common agreement if not by governmental regulation—of an allowable margin of deficiency in weight: but coins reduced through wear and tear below this margin would ultimately have to be rejected: and

(*Money* ch. vii.) refers to “Gresham’s law, that better money cannot drive out “worse,” supported by the experience of the time when “the copper currency “of England consisted mainly of tradesmen’s tokens, which were issued very “light in weight and excessive in number.” But this reference is not quite a satisfactory argument, for such issue appears distinctly fraudulent: and Mr Jevons does not explain why, if government allowed free coining, it should not still interfere to prevent fraud, as it does in the parallel case of weights and measures.

¹ This advantage is not actually secured under our present system.

² ‘Token’ coins would, I suppose, be convertible by the issuers on demand, like bank-notes.

it is obviously unfair that the consequent loss should fall on the individual who, in the passage of a coin from hand to hand, happens to possess it at the exact point of the process of gradual attrition at which it falls below the accepted standard of weight. There seems, however, no effectual way of avoiding this result except that government should undertake the loss and regularly call in light coin.

It is to be noted that if coinage were left to private enterprise, the expenses of producing coins would not really fall on the consumer: since, in fact, they would not fall on any one: they would merely have the effect of raising the exchange value of the coin proportionally above the value of the metal contained in it. Hence *primâ facie*, the same result ought to be brought about, where coinage is monopolized by government: since, if government bears the cost, the public loses collectively, without any corresponding gain to the members of the community. On the other hand the advantages of gratuitous coinage are (1) that it guards against the danger of slight fluctuations in the value of coin relatively to bullion, through temporary over-coinage and stoppage of mint; and (2) that otherwise merchants engaged in foreign trade—where coin is merely used as certified bullion—would necessarily lose the mint charge in exporting the coins, and would therefore have to raise the price of foreign goods in order to transfer the loss to consumers. But I know of no evidence from experience to show that danger (1) is considerable: and as regards (2) there does not appear to be any general reason why foreign trade should be thus specially subsidized at the public expense—in fact, as Jevons urges, the argument rather shows the desirability of establishing an international currency, if it be possible.

The general considerations, therefore, seem to be in favour of defraying the whole cost of coining by reduction in the weight of the coins; and, for the reason before given, this cost ought to include the loss through wear or tear, which should be borne by government calling in the coins that have become too light through use—provided that fraudulent removal of the metal can be adequately prevented.

§ 6. So far we have considered (1) uniformity, and (2) protection against (*a*) fraud and (*b*) unequal incidence of loss, as the

points at which government should aim in regulating coinage. But in considering the vexed question whether one metal or two should be used for standard coins, the importance of another characteristic—*Stability of value*—has to be recognised. Instability in value of the medium of exchange is commonly admitted to be an evil, since the pain of unexpected loss on the whole outweighs the pleasure of unexpected gain, and uncertainty in calculating returns and remunerations is unfavourable to steady industry. We may take it for granted, then, that the State ought to guard so far as it can against fluctuations in the value of the medium of exchange. It can only do this, however, to a very limited extent: as it cannot of course control the conditions of supply of any metal it uses. But there seems to be no doubt that the prospect of stability tends, at any rate, to be somewhat improved, if the metallic currency is, to a substantial extent, made of two metals instead of one: since the probability is that changes in the supply of the two metals respectively will not be coincident, and therefore the extent of fluctuation caused by the changes in supply within any given period will be less, if the mass of coinage affected is bimetallic than if it consisted of either metal alone¹.

Nor can I agree with Jevons that the weight of this general argument is really counterbalanced by the past experience of the greater liability to change in the value of silver; since we know so little of the distribution of the two metals that this empirical law affords slender ground of inference for the future.

I therefore conclude that a substantially bimetallic currency—that is, a currency in which both metals are used to a considerable extent—must be taken to have an advantage in respect of stability. Let us now consider how it is to be maintained and how far counterbalancing disadvantages are inevitable.

As Mill points out, there are two distinct ways in which two

¹ It is sometimes said that the fluctuations will be more numerous though less violent. But (1) an increase in the number of *slight* fluctuations seems to me quite unimportant, as such changes do not produce in a sensible degree the evils of loss or uncertainty: and (2) I should think that the *number* of slight fluctuations ought to be regarded as in any case infinite, since the conditions both of supply and of demand are continually varying.

metals may conceivably circulate together in the form of coin ; either (1) the two metals may be made legal tender at a fixed rate, or (2) one may be taken as a standard while the other is merely coined and currently accepted at its market-value. It will perhaps be convenient to refer to the former system as *Rated Bimetallism*, and to the latter as *Unrated Bimetallism*. The adoption of the latter plan has nothing, I conceive, to recommend it, supposing the dearer metal—say gold—to be taken as the standard : since the cheaper metal—say silver—would only be used for payments too small to be conveniently mediated by gold : and for such payments it would be both more economic for the mint and more convenient for trade to use a *token-currency* of silver. If, however, silver were made the unlimited legal tender, a substantial amount of gold might circulate along with it, owing to its greater convenience for large payments : though I feel doubtful how far this would be the case, in a country with a well-developed banking system, if notes of low value were not prohibited by law ; since such notes would have, as compared with gold, the great advantage of not fluctuating in nominal value. This latter advantage is secured if a fixed ratio of exchange is established by law between the two metals ; and this, I believe, all Bimetallists now recommend. In an earlier chapter¹ of this work I have tried to show that such a ratio can be permanently maintained—in spite of what English monometallists have urged to the contrary—if the fluctuations that would otherwise take place in the relative market-values of the two metals would not be very great in proportion to the aggregate of the currency : since an increase in the supply of either metal which would tend—if there were no fixed ratio—to lower its value will, under the condition of a fixed ratio, tend in the first instance merely to increase the amount of it taken to the mint and to diminish the mint-supply of the other metal ; and so long as the increase of supply is not more than enough to be absorbed by this readjustment of the monetary demand, the market value of the two metals will not tend to diverge from the mint-rate. On the other hand, it seems equally indubitable that when the forces operating

¹ Cf. *ante* Book II. ch. v. § 2.

to raise the value of either metal relatively to the other go beyond a certain point, the metal in question will begin to be exported—or, if we suppose a rate fixed internationally for the whole civilised world, will begin to be melted down—; so that the nominally bimetallic currency will become substantially a monometallic currency in the underrated metal.

The degree of probability that fluctuations of this magnitude will occur is hardly worth discussing in this abstract way; since it depends mainly on two unknown elements—the future conditions of supply of the two metals, and the extent of the commercial society accepting the bimetallic ratio. But I am inclined to think that monometallists somewhat exaggerate the probable mischievousness of such fluctuations if they should occur. The chief effects are two; (1) that the currency becomes temporarily monometallic in the underrated metal, (2) that in the process, the expense already incurred in coining that part of the currency which consists of the other metal is wasted. The latter is, of course, a not unimportant loss: but it may be observed that the same English economists who lay stress on this waste of coinage here, for the most part hold with Lord Liverpool that the community ought to be willing to incur a similar waste for the convenience of foreign traders. And, as regards effect (1), it is evident that, given equal chances of fluctuation for both metals, a nominally bimetallic currency that from time to time becomes substantially monometallic will still be, on the whole, more stable than a simply monometallic currency.

There remains the argument from inconvenience. It is said that if Rated Bimetallism should practically result in a monometallic currency of silver, the inconvenience of so bulky a medium of exchange would be a serious evil. There seems to be undoubtedly some force in this argument: but its importance is much diminished if we overrule, as I should be disposed to do, the objections generally entertained in England to an issue of bank-notes for small amounts.

So far we have been considering the controversy of the Standards, as though the question were one of establishing a currency *de novo*. Of course, it is not in this form that it comes within the range of practical politics. The trade of the world—even,

I may say, the internal trade of the English empire—is actually carried on under bimetallic conditions; and no one doubts that this will continue to be the case for an indefinite period. Indeed the most eager monometallists do not appear to desire the universal adoption of a gold currency, at the risk of a great rise in the value of the medium of exchange. The practical issue therefore, so far as international trade is concerned, lies not between Monometallism and Bimetallism, but between Rated and Unrated Bimetallism.

§ 7. *Paper Currency and Banking.* The governmental monopoly of metallic currency has never, so far as I know, been advocated by theorists,—though in earlier ages it has been extensively used—as a source of public revenue: in fact, as we have seen, the practical question is rather whether it should be a source of expense to the nation. It is universally admitted that the alarm and disturbance to trade that would be caused, if Government tried to gain by reducing the amount of metal in coins while keeping up their value by limitation of issue, would far more than outweigh any profit that might be made by the operation. It is agreed, therefore, that Government ought to coin metal into standard coins freely for all applicants, at a price at least not materially greater than the cost of coining. For similar reasons, it is agreed that the tempting source of gain offered by the power of issuing inconvertible notes should be at any rate reserved for an extreme crisis of national need. But the case is otherwise with notes convertible into coin on demand; it has often been maintained that the State ought to keep in its hands the business of issuing such notes, because the business is one easily rendered both safe and highly profitable under Government management, and would therefore afford a valuable and unexceptionable contribution to the national income. And it is undoubtedly true that by monopolizing this part of the business of banking a Government can practically borrow a considerable amount of capital, at a very low rate: i.e. at the cost of making and circulating the notes, together with ordinary interest on the metal kept as a reserve in order to secure convertibility. This, however, does not prove that it is the interest of the community that such a monopoly should be exercised: there are many highly ob-

jectionable governmental monopolies which the State could easily carry on with considerable profit to the exchequer. What has to be shown is either (1) that governmental management has some important superiorities as compared with individual or associative management in this business: or (2) that, for some reason or other, the extra gain that bankers would make if free issue of bank-notes were allowed would not be transferred to the consumers, by a more abundant and cheap supply of the conveniences of banking. As regards (2) it is, as we have seen, theoretically possible that this transfer might not take place: the extra gains might (*a*) be retained by the banks so far as circumstances exempt them from competition, or (*b*) might be divided among an excessive number of competing businesses, so as to reduce average profits but not charges. I do not, however, know of any general grounds for supposing that these effects would occur; or that competition would not operate in the normal way.

As regards point (1), it certainly seems that the business of issuing notes and giving coin for them on demand is of the routine character suited to governmental management; as admitting of being conducted safely under fixed rules, by which (e.g.) the amount of reserve to be kept is once for all determined¹. And a solvent Government seems to have an important advantage—as compared with private enterprise pure and simple—in being able to provide more complete security at a smaller expense of reserve: partly from the generally greater stability of Governments, partly because a Government, in the last resort, can suspend payment and yet keep its notes current: and it may be added that the greater confidence that a more stable currency inspires is likely to increase its use. And it should be observed that it is not only with a view to more economic production that Government ought to interfere to secure the convertibility of notes; but also for the protection of the poor and ignorant who would be unable to inquire into the circumstances of the different banks whose notes they accept.

¹ I do not mean to affirm that this is the most economical mode of conducting the business of issuing notes. As I shall presently explain, there are strong reasons for holding that a more elastic system would be more economical.

This argument for governmental interference on the ground of security seems to me to have much force, as against absolutely unregulated issue: it seems, however, that adequate security might be provided for the ordinary note-holder¹ while still leaving to private enterprise the determination of the amount of notes, and the proportion of reserve, required from time to time, by placing private issues under strict governmental regulation. Thus—to adopt a suggestion made by Mr R. H. Patterson²—bank-notes might be issued *by* Government, but *for* any bank requiring them, without limit, but subject to the condition that their value should be covered by a deposit of government securities exceeding the nominal value of the notes by an amount sufficient to obviate any danger of loss from depreciation of the securities. The bank for which such notes were issued should be solely responsible for the payment of gold for the notes; but they should be legal tender until the bank stopped payment. Whenever a bank stopped payment, its deposited securities would be at the disposal of the Government for the payment of the note-holders: the notes, in fact, would become practically a kind of exchequer bills; and they would probably continue to circulate in this condition. But even if they did not circulate the ordinary note-holder would at any rate suffer no serious loss from the collapse of the bank responsible for them.

Supposing the value of any note to be secured, either in this way or by full governmental responsibility, there would seem to be no ground for prohibiting the issue of notes below a certain amount; unless such issue should be found to carry with it inevitably a material increase of forgery, which the experience of Scotland does not lead me to anticipate. Apart from this latter danger, the issue of small notes is, of course, an economic advantage to the bankers directly, and indirectly—we may assume—to their customers; no less than the issue of notes for larger amounts is.

But although it seems manifestly possible, by such regulation as that above suggested, to protect the ordinary note-holder

¹ I distinguish the 'ordinary note-holder' from the man of business who is chiefly liable to suffer from a financial crisis.

² Cf. *Science of Finance*, chap. xx.

from material loss; I hardly think that this—or any other scheme for mere *regulation* of issues, as contrasted with absolute *limitation* through State monopoly—would adequately secure the result for which the commercial world is most keenly concerned, by providing a supply of good money in a financial crisis to fill the gap caused by a general collapse of credit. It is true that the agony point of such a crisis in London is when the Bank of England declines to lend even on Consols, and that the dread of this point has a certain tendency to realize itself, as it intensifies the earlier stages of the crisis: and it may be thought that such a scheme as the above would remove this dread, as it would enable any bank to obtain legal tender by depositing its own Consols. And it certainly seems to be quite possible that the pressure of a crisis might in this way receive timely relaxation, so that the crisis might pass off without reaching the worst stage; but I do not see how we can be assured that this would happen; while if the worst stage were reached, if the crisis became panic, the weak side of the proposed system of legal tender notes would become manifest. Every one would fear that the particular bank responsible for his notes might stop payment, and thereby reduce his notes to the condition of mere government debts, not immediately and certainly available for meeting liabilities; there would therefore be a serious danger of a general run for gold, and general ruin. This danger is avoided under the existing system in England; since no one is afraid of the insolvency of the Issue Department of the Bank of England, even when the Bank Charter Act is suspended. And it appears to me that only notes issued by Government, or by a bank which was understood to be practically secure of the support of Government in the ultimate resort, would have the unique quality required to resist the worst storms of distrust that experience shows to be possible.

§ 8. There seem to me, therefore, to be strong general reasons for keeping the function of issuing notes—and of providing a reserve of gold for their conversion—under the responsibility of Government; instead of merely regulating the issue on some such plan as that above proposed. If, however, we yield to these reasons and assume that it is desirable to have a monopolized issue of notes, sustained (in the last resort) by the

credit and authority of Government, in order to guard against the extreme perils of a panic; it is manifest that a step in governmental interference, beyond what we have so far expressly considered, will become necessary. For in order that this end may be attained, in order that the abnormal issues of notes required in a panic may be properly managed, the Government must undertake—directly or indirectly—not merely the function of buying gold with notes and redeeming notes with gold, but also the function of lending notes on adequate security. Thus the department that issues notes must either (1) become a regular bank, or (2) be prepared to perform from time to time, under specially difficult circumstances, the most delicate and important part of the work of a bank; or (3) it must constitute, or enter into alliance with, some individual bank doing ordinary banking business, and entrust these duties to its management. The third of these courses seems the best; since, in the first place, the business of lending money on credit does not seem to be generally more suitable to governmental management than any other branch of commerce; rather it would seem to require the close and keen observation of the state of trade generally, and of individual traders, which it is the special advantage of private enterprise to call forth. And, secondly, a department that had no regular banking business at ordinary times, would hardly be likely to have the knowledge and trained skill required for solving correctly difficult problems of banking at special crises; it would have to depend on the advice of outsiders, liable to be biassed by urgent private interests. But even the establishment of a bank in special connexion with—though not a department of—government tends to produce very important incidental effects on the banking system of the country. The unique security that such a governmental bank affords to depositors gives other banks an inducement to use it for the custody of their reserves; money lodged with the governmental bank is thought as safe as money in a strong box, and less troublesome; and transfers of sums in its books are a very convenient mode of settling accounts among banks. Thus we get the ‘one-reserve system’ that actually exists in England. I do not venture to decide whether this system is on the whole desirable or the reverse; but two remarks may perhaps be made about it without

provoking controversy. On the one hand this one-reserve system, increasing as it does the instability of the vast edifice of credit that is supported on this small basis of gold, renders the danger of crisis and panic proportionally greater; that is, the very need, of which the existence (as we have seen) forms the main justification for governmental interference with banking, must be partly attributed to that interference itself. On the other hand the same interference must to an equal extent be credited with the merit of the system, which lies in its economy; it enables a vast banking business to be transacted at a small expenditure in metallic reserve: and therefore those critics of our Bank Act of 1844 who complain of the large amount of gold lying idle in the vaults of the Bank of England, ought at any rate to recognise that the aggregate expense incurred by the community in keeping gold is less than it would probably be under a system of free banking, under which the leading banks (at any rate) would be likely to keep each its own reserve.

This does not of course prove that the metallic reserve actually kept under the English system might not be safely reduced; or that it might not be turned to better account, if the connexion between the Government and what we have called the 'governmental bank' were established on a different plan. Indeed it seems evident that if the Bank of England had full discretion in determining the proportion of reserve to notes issued, it would at least have the power of performing its functions in a manner more advantageous to the community than at present. To show this, we will suppose that the Bank is now keeping practically¹ about eleven millions of metallic reserve to meet the liabilities of the banking department, and about ten millions more to meet those of the Issue Department. It is evident that as now the latter reserve cannot be used for banking purposes, its existence does not give any additional strength to the banking department; so that any given drain of gold acts on the banking reserve with much greater force than it would exercise if the bank were left free to treat the two reserves as one.

¹ Of course the reserve in the Banking Department actually consists mainly of notes; but as gold corresponding to these notes is kept in the Issue Department, the result is practically that stated in the text.

Hence it would seem that if the Bank were unfettered, the rate of discount would *ceteris paribus* be decidedly less liable to be affected by slight and transient movements of gold than is now the case; so that the rapid and large fluctuations in interest, which are recognised as a bad result of our existing system, would be reduced, other things being the same. On the other hand it is bold to assume that other things would remain the same: or rather—for the present reserve may very likely be too large—that the Bank would take all due precautions to avoid the risk of having to suspend payments. Indeed when we consider merely from an abstract point of view the proposal to give a particular joint-stock company an exclusive privilege of issuing notes, the value of which will, in the last resort, be sustained by the authority of Government, without subjecting its exercise of this privilege to any governmental control whatsoever; it certainly appears a very hazardous measure. If we suppose the Bank to be governed by the vulgar desire of private gain, it will, in determining the proportion of notes to reserve, consider the risk to itself and not the risk to the community; and though the danger to itself from an inadequate reserve would be serious, it would be less than in the case of an ordinary bank—since we have supposed that Government would, in the last resort, intervene to sustain the currency of the notes.

It remains to consider briefly whether, supposing that there is a legally determined *normal* limit of the uncovered note-issue, it is desirable that the relaxation of this restriction should be only obtainable by irregular governmental interference, or that it shall be regularly purchaseable by the Bank? If the price of the relaxation were placed sufficiently high, if (e.g.) the bank had to pay 5 per cent. for any excess over the normal amount of uncovered note-issue, the difference between the two plans would seem to be chiefly political rather than economical: neither resource would be brought into play except in an extreme emergency, but the former would have the advantage of avoiding the bad constitutional precedent set by the irregular suspension of a law. But the former measure would work very differently, if the price paid were so small that the extra issue could be counted on as an ordinary mode of relieving the pressure on the money-market; such a regula-

tion would, I think, be an awkward combination of control and freedom: just when the Bank's relations with the commercial world became most difficult and delicate, the responsibility for yielding to the pressure for loans would be partly taken off its shoulders by what would appear to be express governmental provision for extended issue.

I have said that that part of an ordinary banker's function which consists in lending money to traders and other employers of capital is not a business in which governmental management is likely to have any special advantage. On the other hand, as a borrower of money the Government of a well-ordered and prosperous community is able to give a higher degree of security to its creditors than even a large joint-stock company can do. Hence governmental agency is specially adapted for taking charge of the savings of persons, to whom security is generally of more importance than high interest, whether such savings take the simple form of depositing money, or the more complicated form of payment for life-insurance, purchase of annuities, &c. Moreover there are particular departments of the business of lending, where the risk may be reduced to a small amount, which appear, from their routine character, to be not ill suited to governmental management. Thus there seems to be no particular reason why Government should not lend money on the security of land, as I shall presently notice; or even, for short periods, on moveable pledges, the value of which is not likely to change materially in a short time nor difficult to ascertain approximately: and in fact experience¹ renders it probable that, by establishing a governmental monopoly of pawnbroking, loans can be remuneratively made to the poor on easier terms than open competition would enable them to secure. There is the further argument for such a governmental monopoly that it considerably decreases the difficulty of preventing pawnbrokers from becoming practically receivers of stolen goods².

§ 9. I pass to notice certain important cases in which the interference of Government has been widely exercised and still

¹ See statistics given in an article on *Pawnbroking at Home and Abroad*, by Rev. W. Edwards, in *Nineteenth Century*, June, 1831 observing, however, that the *Monts-de-Piété* in France are only partially self-supporting.

² The distributional arguments for these measures will be noticed in ch. vii.

more extensively solicited in the interest of production; but which yet hardly admit of being definitely classed under the head that we are now discussing, because they have been so largely advocated as means to other ends—the relief of distress, the increase of political security and stability, the amelioration of the moral or intellectual condition of large classes of citizens, or the attainment of certain ideal aims of social human progress. The departments that I have in view may be briefly indicated by the names Education, Emigration and Land-tenure;—the last two being to some extent connected.

Of these departments the first is undoubtedly the most important, if we take the term in an extended sense, to include all institutions or regulations for the promotion of culture, either of adults or of children. Here first it should be observed, that though the same machinery may partly serve the two purposes, still the principles on which Government intervenes in the education of children are importantly different from those upon which its assistance is claimed for the intellectual improvement of adults. From the fundamental assumption of the system of natural liberty, that a man is the best guardian of his own interests, it by no means follows that he is the best guardian of his children's interests; and, in fact, in the freest of modern communities, it is found necessary to sustain by legal sanctions the parent's obligation to provide even for the material wants of his children. It is, therefore, no contravention of natural liberty to secure them a minimum of education by the same legal compulsion; but the expense of this education, if not artificially reduced by pecuniary aid from Government, would—in almost any civilised society—be so serious a burden on the poorest class, that it would be practically impossible to make the compulsion universal: and, as was before pointed out, the community derives an economic gain¹ from the education of its younger members—so far as they are thereby rendered more efficient labourers—which the self-interest of private employers cannot be relied upon to provide, owing to the difficulty of appropriating the advantage of the increased efficiency. Hence

¹ It may be observed that a certain portion of this gain to the Community will tend to appear as a definite national gain to the national exchequer, in consequence of the increased taxes paid by the more productive labourers.

a national provision for education may to some extent be considered and justified as a measure for improving national production. The instruction, however, that is thus made compulsory and artificially cheap on this principle should be strictly confined to imparting aptitudes of incontestable utility to industry; and whatever it is made universally obligatory to acquire should, of course, be universally useful.

But further; there may be the same general economic justification for cheapening by governmental aid the special training required for skilled labour, as there is for cheapening elementary general education: that is, the community may gain an adequate return for its expenditure in the greater abundance and better quality of the skilled labour so provided. This argument would hold, independently of any assumption that natural liberty is not likely to provide the right kind of training for those who can afford to pay for it. In fact, however, this assumption has been very generally made by those who have defended or solicited the intervention of modern Governments in the preparation for various trades and professions. Even in the case of the lower kinds of skilled labour, it has been widely thought that the traditional custom of learning a trade by apprenticeship—i.e. by mere practice and the casual intermittent instruction that persons engaged in the work can find time to give to beginners—has actually led to very unsatisfactory results: that the skill thus acquired tends to be mechanical and unprogressive, and not even so cheap as it appears, owing to the long time spent in its acquisition; and that therefore it is a socially remunerative employment of public money to organize and artificially cheapen systematic technical instruction¹. In the case, again, of the higher kinds of skill required for what are called the learned professions, the incapacity of ordinary persons to judge of such skill has been generally recognised as a ground for governmental interference to ensure a certain degree of competence in recognised members of these professions: and most civilised Governments have not been content to secure this by requiring certain examinations to be passed by such persons; they have also given salaries to teachers appointed to impart

¹ Several civilised governments spend considerable sums for this end: though the details of its employment are very different in different countries.

the required knowledge at low charge, in universities or otherwise. A modern university, however, is not merely an institution for imparting special kinds of knowledge for professional purposes; it has also the function of advancing knowledge generally and facilitating its acquirement by students whose aims are purely scientific. This speculative pursuit of knowledge is to a large extent—and to an extent incapable at any given time of being definitely determined—indirectly useful to industry; and since, as was before noticed, its results cannot usually be appropriated and sold, there is an obvious reason for remunerating the labour required to produce these results, and defraying the expenses incidental to the work, out of public funds—at any rate if a provision adequate for the purpose is not available from private sources.

Besides oral instruction, in modern times, access to books is a most important means of spreading and advancing knowledge. Libraries, indeed, are among the essential instruments of academic teaching; but, as has been strikingly said, a library apart from oral instruction is itself a cheap university. The institution of free libraries and museums supported at public expense is perhaps most frequently advocated, just as a national provision for elementary or higher education is, from a *distributional* point of view, as a harmless and salutary form of communism; still the great indirect advantage that the community gains through the general spread of intelligence, and especially through facilitating the acquirement of knowledge by exceptionally gifted persons, is at any rate an important consideration from the point of view of production. And even in the case of galleries and museums of Art this consideration comes in to some extent, so far as artistic cultivation improves artistic production.

Before leaving this subject it should be observed that by far the most extensive application of public funds to the culture of adults, in most modern European communities, consists of a provision for religious worship and instruction. It would, however, be obviously incongruous to dwell on this in the present connexion: and in fact the interference of the State for this purpose, considered from a purely secular point of view, is rather to be justified on account of the value of the clergy as “spiritual

“police”—that is, from the indirect aid given by them to the necessary governmental function of preventing crime.

§ 10. I pass to consider the interference of Government in order to promote or regulate the migration of human beings from densely populated districts to others that are wholly or partially unoccupied. Such interference has sometimes been prompted by considerations not primarily economic; thus the colonization of a region forcibly annexed, or unable to resist the intrusion of strangers, has been fostered in order to facilitate or confirm a conquest of territory: on the other hand, in some countries the immigration of foreigners generally, or of persons of alien race or religion, has been prohibited or hampered, in order to protect the native civilisation from the intrusion of subversive elements; elsewhere, again, immigration of a certain kind has been encouraged in the interests of morality and social well-being—as (e.g.) when female immigration has been promoted to prevent a great inequality of the sexes in a new colony. The grounds and limits of such kinds of interference it is beyond my province to discuss: and the same may be said of the measures now taken by our Government to secure the sea-worthiness of ships, and the sufficiency of their supply of provisions, water, medicine, &c., since these latter regulations belong to the class of interferences for other than strictly economic ends, which were briefly surveyed in the preceding chapter. Confining ourselves to such governmental encouragement or control of emigration as has been undertaken or recommended on distinctly economic grounds, we may regard it generally as a case closely parallel to that of education, which we have just been considering: the principle of either kind of interference is that there is a possible gain to the community, which *laissez faire* is not likely to realize, through the increase of the efficiency of certain labourers—in the one case by developing their personal aptitudes, in the other by placing them in more favourable outward circumstances. In the case of emigration, however, the distribution of this common gain among the various classes of persons affected usually admits of being somewhat more definitely foreseen than in that of education. If the benefit consisted exclusively in an increase of income to the emigrants themselves, it would hardly, I con-

ceive, be proposed to defray their expenses out of the general taxes. But this supposition is very unlikely to be realised in practice. In the first place, supposing the region of immigration and that of emigration to have the same government, the increased taxes subsequently paid by the immigrants would generally yield the public a certain return on the cost of conveying them; against this, however, we have to set the increased expenditure required for the adequate fulfilment of the functions of Government towards the immigrants under their changed circumstances; and since it is generally reasonable to suppose that a certain portion of the assisted immigrants would have come at their own expense if they could have got no aid from Government, it would only be under very special circumstances that the increment of taxes really due to the outlay of Government in assisting them would amount to full interest on the outlay. But generally speaking, when emigration is successful, measurable advantages accrue from it, over and above this increment of taxation, to other members of the community, or to the community as a whole.

Here it is important to distinguish (1) the advantages gained by persons who employ the immigrating labourers, (2) the gain of those who exchange products with them, either as ultimate consumers or for purposes of trade and production, and (3) the relief obtained from overcrowding. In England, during the second quarter of this century, extensive governmental aid to emigration was often urged strongly with a view to this last-mentioned benefit; but there is an obvious danger that the desired relief would be merely temporary in the first instance, and, if the aid were continually renewed, would cease to produce the remedial effect, since it would operate merely as a partial removal of the checks that normally keep down population in an overcrowded district. Hence economists are now generally agreed that, in a modern industrial society, governmental aid to emigrants, considered as a relief to the pressure of population in the region of emigration, is only to be recommended as an exceptional *eleemosynary* measure, in case of unexpected and abnormal distress; unless it can be undertaken on such a scale and in such a manner that there is a reasonable probability of its causing a change in the habits

of the over-dense population sufficient to bring about a permanent cure of the over-crowding. On the other hand, during the long sway of the 'Colonial Policy' that Adam Smith assailed, the chief advantage derived by the mother country from colonisation was generally understood to consist in the extension of trade that it brought about: and no doubt this gain, if the colony flourishes, is generally likely to be in the long run considerable¹; but it can rarely be sufficiently certain and definite to render it anything like a profitable outlay for a community to send out colonists at the public expense, for the sake of the profit of their trade to the mother country;—even supposing this gain could be monopolized by the elaborate system of restrictions on colonial trade and prohibitions of colonial manufacture which the pre-Smithian policy developed. There remains, as the clearest economic gain resulting from emigration to others besides the emigrants, that which accrues to the owners of land and employers of capital in the region of immigration; the resources of this region being supposed to be so far undeveloped, that considerable additions to the labour and capital employed in it may be made, with an increasing rather than diminishing return to both. At first sight this would seem to be a reason for leaving the business of introducing emigrants to the private enterprise of the landowners and capitalists who might obtain a full return for it in labour; but there is a serious obstacle to private enterprise in the uncertainty of the profit on such outlay to any individual capitalist, owing to the difficulty of enforcing labour-contracts for a considerable term of years,—especially in a very thinly inhabited country—without introducing something like temporary serfdom. Hence, supposing all such serfdom—even of criminals or men of lower race—to be excluded on moral or political grounds, the intervention of the public purse is likely to be necessary for the effective introduction of the required labour.

§ 11. This intervention will be facilitated, if the unoccupied lands of the region of immigration are owned by the community,

¹ The extent of this gain, as Merivale points out, will be very different in different cases; it is conceivable that large numbers of emigrants may be settled and comfortably maintained in a colony, where the net produce exported is yet comparatively insignificant. Cf. *On Colonization*, Lec. ix. and xiii.

so that the sale or lease of them supplies a fund from which the expense of importing colonists may be defrayed. And in fact (as I before noticed) the question of governmental aid to immigration has had a close historical connexion with the regulation of the acquisition of land in a new country. Here the theoretical problem of determining the grounds and limits of legitimate interference is complicated by a peculiar difficulty of deciding what is, and what is not, interference; or, to put it otherwise, what precise action on the part of the Government would strictly conform to the principles of natural liberty. At first sight it would seem that in new countries, as Merivale¹ argues, "the 'natural' course of settlement is that which would take place, not if land were sold at the sum which it will fetch, but if it were granted away without any purchase at all. Free grant is the natural system; deviations from it...produce artificial, though perhaps very useful effects." But this view seems to me to overlook the peculiar characteristics of property in land which render it impossible or manifestly unreasonable for Government to act on the simple principle of securing it to the first occupant. In the first place, how shall we determine the extent of occupation? it cannot be said that a man is to be understood to occupy what he is able to use, because the 'use' of land by any individual may vary almost indefinitely in extent, diminishing proportionally in intensity---e.g. it would be absurd to let any individual claim possession of the whole ground over which he could hunt, as against another who wished to use it for pasturage: but if so, ought the shepherd, again, to have possession as against a would-be cultivator, or a cultivator as against a would-be miner? Even if we confine our attention to one kind of use, similar difficulties occur: there is no natural and obvious definition of the quantity of pastoral land useful for a given number of sheep or cattle, or of the quantity of tillage-land suitable for a given amount of labour---especially where the kind of tillage most immediately profitable is that which exhausts the soil---or, again, of the amount that a miner may legitimately claim. The settlement of these questions must in any case require the intervention of

¹ *On Colonization* (edition of 1861) Lec. xiv. p. 416.

Government: but, apart from these difficulties of detail, the general principle of allowing complete property rights to the first occupant does not seem properly applicable to land. For the economic ground on which this jural principle is based, in the case of the produce of hunting, fishing, and other occupations by which things become property that have hitherto been unappropriated, is that the labour of search and pursuit thus receives its natural remuneration, without which there would be no adequate inducement to perform it: but no such labour is required in the case of ordinary land in a new country: there is no advantage to the community in allowing the first comer to appropriate it gratuitously to-day, if some one else is likely to come to-morrow who will be willing to pay for it.

In short, if land before it is occupied has a market-value, it would seem that the competition of the market is the 'natural' method of determining what individual is to possess it, the price thus obtained belonging naturally to the community; and hence that Government should undertake the business of owning it, so far at least as to arrange for selling it in the most economical way. Nor does it even seem clear that this ownership should be as brief as possible, and should be transferred at once by sale to the highest bidder. Indeed, it is obvious that if more than a certain limited amount of land were offered for sale at once, at whatever price it would fetch, the value of it would fall so low that the practical effect would be nearly the same as if gratuitous occupation were allowed: and if it be said that it should only be sold to those who can really use it, the before-mentioned difficulties arising from the great variations in intensity of use recur in a different form—e.g. a wealthy shepherd could use a large province at the rate of 100 sheep per square mile, which is taken to be the carrying capacity of pastoral land in Queensland; but it would obviously not be fair to let him have a province for private property at a nearly nominal price, if in a few years the progress of colonization is likely to give large parts of the same land a substantial value for agricultural purposes. It is clear rather that where land is likely to be in demand both for agricultural and pastoral use, the claims of the different uses can only be fairly adjusted by allowing the shepherd a temporary occupancy of land that is not yet required for agriculture.

Shall we conclude, then, that Government is acting in accordance with the principles of Natural Liberty if it allows the alternative of sale or lease, and the terms of either, to be decided by purely commercial considerations, merely endeavouring to make the best bargain for the community? But if so, it may be plausibly urged that it should never part with the land at all, but only sell from time to time the temporary use of it; in order that the increment of value through the scarcity of land of certain quality or position, which the increase of population has continually caused, may be secured to the national exchequer. Certainly it seems that, on strictly commercial principles, land ought only to be sold at a price that will fairly include the present value of this prospective increment; and that if, as seems probable, individuals are not sufficiently interested in remote and doubtful gains to rate this increment at its true value, at any rate during the earlier stages of the economic life of a colony, Government ought, during this first period, not to sell the land at all, but only to let it on lease.

But further, assuming that land is to be sold out and out, there is still a difficulty in saying how the quantity to be sold, and the mode of selling—whether by auction or fixed price—are to be determined in accordance with the system of natural liberty. For if we say that they should be determined on strictly commercial principles, so that the best bargain may be made for the community, it still remains to be considered whether it may not be even financially better for the community to sacrifice immediate gain to the end of encouraging population. The controversy between the advocates of low and high prices and the discussions as to the best mode of securing *bond fide* settlement, and the extent of credit that should be allowed to *bond fide* settlers, would not be excluded even if the aim of Government were limited to securing the greatest possible gain to the national exchequer.

Actually, this aim has been generally quite secondary in the colonization of England, the greatest colonizer among modern communities: the financial interest of the community has been subordinated to the end of promoting immigration. The most obvious way of doing this is by the system of free grants, or sale at low prices, in such portions and under such conditions as are

thought likely to secure the actual cultivation of the land. This, in fact, is substantially the same thing as paying a part of the expenses of the transfer of emigrants out of national funds, provided the emigrants were of the class that would in any case buy and cultivate land—since it obviously makes no difference to a man whether it is the cost of his journey or the cost of his purchase of land that is artificially cheapened at the public expense. In practice, however, this system, in the form in which it prevailed generally in the English colonies during the 18th and the first quarter of the 19th century, was not effectually guarded from being perverted to the profit of speculators¹: and the system that has been more recently adopted of making the benefit offered to settlers to consist more in the deferring of payment than in the lowering of price, seems in every way preferable.

A different and more elaborate plan of promoting emigration through the sale of unoccupied lands, which we may call the Wakefieldian system², was urged upon the English Government

¹ e. g. in Lower Canada, the regulations restricting the amount that could be granted to a single person were so effectually evaded that 1,425,000 acres were made over to about 60 individuals, during the government of Sir A. Milne. (Merivale, Lec. xv.)

² The influence of Gibbon Wakefield on English Colonization deservedly occupies an important place in the history of political and economic speculation, no less than in that of English colonial policy: but it seems to be a matter of considerable difficulty to ascertain exactly the fundamental principles or characteristics of his system. Thus Mill (*Pol. Econ.* Book v. c. xi. § 14) represents it as an essential point in Wakefield's system that it promotes concentration of settlements; since "by diminishing the eagerness of agricultural speculators to add to their domain, it keeps the settlers within reach of each other for purposes of "cooperation." But it would seem that the "uniform price" on which Wakefield insisted—as compared with the varying price that would result from sale by auction—would tend against concentration, by increasing the settler's inducement to select land for its fertility rather than for its situation. And Wakefield himself (*Treatise of the Art of Colonization*, Letter LXVIII.) expressly disclaims any wish to promote concentration of settlements, provided that combination and constancy of labour is secured to each settler by an abundant supply of hired labourers. "With respect to the choice of land for settlement," he writes, "the settlers must be the best judges...I would if possible open the whole of the "waste land of the colony to intending purchasers...dispersion or concentration "is a question of locality alone." Again, it was not really an essential part of Wakefield's own scheme that the proceeds of the sale of lands should be devoted to the support of emigration; though most writers on the subject seem to regard this as quite fundamental to it. Mr Merivale even speaks of this (*On Coloni-*

by the Colonization Society from 1830 onwards, and partially carried into effect for a limited period in some of our Australasian colonies. It will be observed that the immigration encouraged by the system of free grants or low prices is that of labourers who intend, and are expected, to become cultivators of their own land at once. Now it was believed by Wakefield and his followers that the labour of immigrants so attracted tended to lose materially in efficiency through want of cooperation; so that it would be a distinct gain to production if they were to a large extent prevented from buying land and their labour organized under the direction of capitalist employers. The characteristic principle, then, of the Wakefieldian system was that it aimed at attracting such capitalist employers by providing them with labourers willing to work for hire. With this aim it was proposed to sell land at a price so high that the mass of immigrants would not for some years afford to buy enough to become cultivators on their own account; and at the same time to devote the whole, or a fixed and substantial part, of the proceeds of such sales to the importation of immigrants,

zation, *Lee*, *xiv.*) as "the great discovery of Mr Wakefield;" and at the same time, while emphasizing its practical value, urges as a theoretical objection against Wakefield's system that while the "sufficient price" of which he habitually spoke had to serve a double purpose,—that of restraining labourers for a sufficient, and not more than sufficient, time from the acquisition of land, and that of keeping up the supply of labourers by gratuitous importation—it was nowhere shown that the price adequate for the one purpose might not be either more or less than adequate for the other. But in Wakefield's own treatise this second purpose is treated, in the most express and emphatic language, as merely secondary and incidental. "So completely" he says (*Letter LIV.*) "is the production of revenue a mere incident of the price of land, that the price ought to be imposed—if it ought to be imposed under any circumstances—even though the purchase money were thrown away:" since, as was explained in the preceding letter, if only all labourers were under the necessity of remaining labourers, it would be "possible and not difficult for capitalists to enforce contracts for labour made in the mother-country," as "the temptation of the labourer to quit the employer who had brought him to the colony would be no longer irresistible." Under these circumstances it seems to me a mistake to regard the plan of dealing with waste lands that was temporarily carried out in the Australian Colonies as Wakefield's scheme: since, as he reiteratedly affirmed, his "sufficient price" was never really tried, and this was his cardinal point. But since the plan actually adopted was due to the influence of Wakefield and his friends, and bore a certain resemblance to his scheme, I have still ventured to speak of it as "Wakefieldian."

so that the immigrating capitalists might always find an adequate supply of hired labour ready to hand. The partial attempt that was made to carry out this system in our Australian colonies, for the 15 or 20 years from 1836 onward, had, in the opinion of competent judges, an important degree of success¹. And the fact that it was afterwards abandoned is hardly evidence that it ultimately failed; since its abandonment may be plausibly attributed to the mere desire of obtaining land on easier terms generally felt by the labouring class, whose influence over colonial administration became preponderant when self-government with universal suffrage was granted to the colonies.

§ 12. From considering the principles of governmental interference with land in an early stage of a country's development, let us pass to examine briefly the economic reasons for continuing such interference when this stage has been passed, and the country has been fully occupied. We may conveniently divide this question into two parts; asking first under what limitations land should be allowed to pass into private ownership, and secondly why and how far, after this transition has taken place, government should still exercise a special control over this particular kind of property. As regards the first question, it is obvious that such portions of land as are manifestly more useful to the community when thrown freely open to common use should be retained in public ownership, and under governmental management: e.g. roads, navigable rivers and inland lakes, natural harbours, public parks, commons, &c. So, again, there are strong reasons, discussed in the earlier part of this chapter, why the land required for railroads or other similar monopolies should not be allowed to pass, except temporarily, out of public ownership: and a general right should be reserved of taking back from private owners any land that may be needed for public uses, at its market-value as determined independently of such need, with a slight addition by way of compensation for any special utility that it may have for its owner². Actually, we find that, in most modern European

¹ Cf. Merivale, *Lec. xiv.*, and Cairns' *Political Essays*, Essay 1.

² This right has been extensively exercised in recent times in the construction of railways, and is now generally recognised in the most advanced communities.

countries, considerable portions of the land used in ordinary agricultural production have remained in the possession of monarchs, and so have become practically the property of communities, after the transition from feudalism to the modern economic order of society. But, generally speaking, there seems no reason for keeping ordinary agricultural land under governmental management,—since the general arguments in favour of private management are at least as applicable to agriculture as to any branch of production—except so far as some small portions might advantageously be retained for purposes of scientific experiment or technical instruction. The chief exceptional case is that of land on which timber is grown: where there appear to be the following special arguments in favour of government management; first, the economic advantages of conducting this business on a very large scale, as it gains much by highly skilled and carefully trained labour which, at the same time, requires a very large area for its most economical application: secondly (what was before noticed), the interest which, in certain countries at least, a community is believed to have in preserving a due proportion of trees to the soil that it inhabits, owing to their beneficial effect on climate¹; while, thirdly, it is thought that even the marketable utilities of trees—especially their utility, where coals are scarce, for fuel—are in danger of not being adequately or most economically provided for distant generations, if the provision is left to private enterprise, considering the slow growth of trees and the general unattractiveness of remote returns to the private undertaker.

With the exception, however, of timber, it is generally admitted that the ordinary products of agriculture, whether animal or vegetable, are likely to be most economically supplied by private undertakers. But it is a different question whether it would not be expedient to retain land in public ownership, while leasing it to private persons; so that the increase in its value which the increase of population tends to cause may be continually secured to the community. This measure is more usually advocated from the point of view of Distribution, in which aspect we shall have to consider it in

¹ In England, I suppose, this consideration can scarcely have practical importance.

a subsequent chapter: from a productional point of view its main advantage would consist in the saving to the community of a portion of the cost of taxation; on the other hand, a certain amount of loss to production seems an inevitable consequence of a system of leasehold tenure, owing to the difficulty of framing, and still more of effectively enforcing, such terms of lease as will give the lessee as much inducement to treat the land in the most economic way as the owner would have. Actually the whole rent of land has never been retained by any government; but in many cases a considerable portion of it has been reserved, either under the name of rent, or under the rather misleading name of a land-tax¹.

But again; it is quite possible to allow the surface of the soil to pass completely into private hands, while reserving to the community the rights of property in certain of the minerals contained in it: and in fact some reservations of this kind are found in the codes of some of the most advanced communities². The general argument for such reservations, from the point of view of production, is that the owner of the land, whether engaged in the business of agriculture or not, may very likely not be the person best qualified either to ascertain the presence of minerals hidden some way below the surface, or to decide whether their extraction will be remunerative; so that production will gain if the right of discovering and working them—with due compensation to the owner for the loss of the land thus rendered useless for agriculture,—be allowed to members of the community generally³.

¹ The distinction between this reserved share of rent and an ordinary tax will be examined in a subsequent chapter (c. viii).

² Even in England, where this kind of interference is at its minimum, gold and silver mines are legally reserved to the crown.

³ In Prussia, for instance, according to the mining law of 1865 any one wishing to bore or dig (*schürfen*) for any of the minerals to which this "mining-freedom" (*Berg-bau-freiheit*) extends must be permitted to do so under condition of paying adequate compensation, provided that the operation is not carried on in certain specified places, as within a certain distance of buildings, in churchyards, gardens, &c. In default of agreement between the parties as to the compensation, it will be determined by the "Ober-Berg-Amt." Such compensation will take the form of rent, unless the operations are continued—or may certainly be expected to last—longer than three years: in this latter case the landowner may force the miner to purchase the land. If the miner by

In special cases, however, governmental management of mines may be expedient either to avoid the drawbacks of monopoly in private hands—in the case of very rare minerals—or to watch over the interests of posterity, as in the case before discussed of forests.

§ 13. The restriction of private property in the contents of the earth may hereafter become a matter of great practical importance, through the progress of geology and the gradual exhaustion of the stores of valuable minerals easily obtainable. At present, however, much more attention is given to the question of governmental interference with land used for agriculture or building. The interferences of this kind that have actually been carried out are to be classed under very different heads, even if we confine ourselves to those that have been recommended on strictly economic grounds and in the interest of production. In the first place we put aside, from our present point of view, the very important cases in which European governments¹ have intervened not to restrict the liberty of individual owners but to render it more complete; by removing relics of feudalism which divided the rights of ownership of land generally in various complicated ways between lords and cultivators, and further impeded its transfer through the restriction of particular estates to particular classes—nobles and *roturiers*, or nobles, burghers and peasants. Akin to these are more permanent laws restricting the right of each generation to restrict the freedom of their successors, by such bequests or contracts as would hamper the alienation of land, and tend to prevent it from getting into the hands of the persons who would make the best use of it. For legislation of this kind, as was before said, can not strictly be regarded as an interference with natural liberty; it is rather a compromise adopted in an inevitable collision of freedoms, to secure the fullest possible realisation of the economic advantage of *laissez faire*. Similar to this, again, is the aim of another class of minor interferences,—such as the compulsory registration of dealings with land—

taking portions of any given piece of land would destroy the value of the remainder, he may be forced to pay rent for, or to purchase, the whole.

¹ As in France at the Revolution of 1789; and in Prussia by the legislation of Stein and Hardenburg (1807–11), further developed and completed in 1850.

which are designed to render the sale or mortgage of land more easy and less expensive, by removing the necessity of complicated and costly legal proceedings. Along with the above, again, we may class the intervention of the legislature in order to substitute, in the case of land cultivated by other persons than its owners, a certain and definite tenure for one regulated by more or less uncertain customs and understandings; so far as such legislation does not override freedom of contract, but merely interprets what is left vague in customary agreements, or defines normal conditions of letting—as regards length of tenure, compensation for improvements, &c.—in default of express contract to the contrary. When, however, the governmental determination of the conditions of letting land is compulsory, and *pro tanto* prevents freedom of contract between owners and tenants, the interference is of course of a much graver kind; and such as can only be justified by clear evidence either that it is not for the interest of the landowner to grant such terms of letting as would give the tenant the greatest possible inducement to make the land productive, or that the former, if let alone, is likely to mistake his own interest. The very extensive interference with freedom of contract which has recently taken place in Ireland has not, I conceive, been introduced altogether or perhaps mainly in the interest of agricultural production; its object has partly been to increase the incomes of tenant-farmers, for the satisfaction of philosophic sentiment or historic claims of justice, or to meet political exigences. So far, however, as it has been advocated from a productional point of view, the contention has been that the Irish landowners, under the system of free contract, have (1) been often found to raise the rent so high as to leave the tenants but bare subsistence, and so prevent them from having the capital¹—or in bad times even the physical vigour—requisite to render their labour adequately efficient; and so have (2) diminished the tenants' inducements to treat the land in

¹ It may be said that it would be profitable for the tenant to borrow capital from his landlord—or some one else—if he would be more than compensated by the additional productiveness of his labour: but the additional element of risk introduced by the necessity of relying on merely personal security may render this unprofitable.

the most economic way, by not securing to him the value of his improvements. The second of these defects is said to attach also to the English system of land-tenure and is now made the ground¹ of advocating compulsory compensation for improvements in England. How far these contentions are in fact valid, I do not now inquire: but we have before seen that the first-mentioned result is quite a possible one, even on the supposition that all parties are actuated by enlightened self-interest; since even when an increase in the incomes of tenants or labourers would lead to a more than equivalent increase in the value of their labour, it is obviously not the interest of the landlord to furnish the increment of income unless he is to profit by the increased efficiency. Now in the case we are considering, the increased produce would in the first instance be appropriated by the tenant: and even where the loss to the landlord would ultimately be compensated by a rise in rent or perhaps by greater regularity in its payment; the prospect of this compensation may easily be too remote and dubious to induce the landlord to make an immediate and certain sacrifice of income in order to obtain it.

So again, it may either be, or more probably still may seem, inexpedient for the landlord to give the tenant, through lease or otherwise, the fullest security of profiting adequately by his improvement of the land; because such security cannot be given without diminishing the former's control over his land more than he likes or thinks expedient. The simplest method of giving this security is by a long lease; but we have already noticed the difficulty of framing a lease that without hampering the tenant will practically make it his interest to treat the land in the best way; and, where tenants are poor, a long lease is open to the further objection, in the view of the landlord, that the benefit of an unforeseen rise in the value of the land will accrue entirely to the tenant for the period of the lease, while the landlord is likely to bear a considerable share

¹ This interference is sometimes demanded in the name of natural Justice: but such a claim appears to me due to confusion of thought—at any rate no jurist that I know of has ever propounded the principle that a man has a right to the results of his labour if it has been knowingly applied to the property of another.

of the loss due to an unforeseen fall, through the actual or threatened insolvency of the tenants.

Taking into account all difficulties of this kind, and not overlooking the more indefinite loss of the stimulus given to industry by the sentiment of property, we may conclude that there are inevitable disadvantages to production involved in a general separation of the ownership of land from the business of cultivating it: which would probably prevent this from being the common practice if land were held merely as an instrument of production. But in England this consideration has been outweighed by other powerful motives, in particular by the traditional social prestige and political influence attaching to the possession of land. Hence some reformers consider that an important gain to agricultural production would be secured by breaking down the tendency of large estates in England to remain in the possession of the same families from generation to generation: and that this would be attained by assimilating the law of real to that of personal property, and conferring on life-owners an inalienable right of determining the distribution of the property thus owned among their children after their death¹. It seems doubtful, however, whether even these changes would have the desired effect in a wealthy country; since the peculiar gratification of the sense of proprietorship which the possession of land gives, and the attractions of country residence and field sports would still tend to keep great portions of it in the hands of rich persons not desirous of personally superintending its cultivation.

The question of interference on the grounds above mentioned has been practically a good deal mixed up with one which, theoretically considered, involves economic reasoning of a very different kind: the question, namely, whether agricultural production should be carried on on a large or a small scale. The ownership of land by rich persons who do not personally manage its cultivation, has a certain tendency to encourage

¹ This has also been proposed with the view of facilitating the alienation of land: but this latter end seems to be sufficiently attained by securing to the life-owner of land an inalienable right to sell any portion of it (under proper restrictions as to the investment of the proceeds of the sale)—which is, speaking broadly, the effect of Lord Cairns' Act just passed (1862).

large farms, since it is less troublesome for the owner to collect rents from a few large farmers than from many small ones; and again, the large farmer, having more capital, is not so likely, if holding under a lease, to throw the greater share of any unforeseen losses on the landlord. Hence it is *a priori* probable that this system of ownership prevents the existence of a certain amount of small farming which might otherwise be prosperously carried on; there are, however, no adequate reasons for supposing that farming on a small scale is likely to be generally more economical, at least as regards the chief staples of agriculture.

Here, however, another consideration is often introduced, which, as was before noticed, is not directly included within the scope of the present discussion, as I have defined it. It is maintained that the system of small farming tends to give a greater gross produce, though a smaller net produce, than that of large farms; and therefore ought to be encouraged by Government, as tending to increase population—though not average wealth—within a given region. Whether this result ought to be aimed at, I shall not discuss: but it is certainly a possible result, if the increase in gross produce due to the small-farm system decidedly outweighs the decrease in net produce—unless, however, the latter difference were comparatively slight, this organization of agricultural industry would be always in a state of unstable equilibrium, since the greater profitableness to employers of the large-farm system would be continually tending to introduce it.

Finally we must notice a kind of interference which has actually taken place in England, and has often been advocated in the interests of agricultural production; but which is not to be so regarded according to the definition of produce adopted in the present treatise. I refer to the law that gives the occupier of agricultural land an inalienable right to kill certain kinds of game, on account of the damage done by them to crops. For this interference with free contract can only be required for the end in view, on the ground that many landlords prefer game and sport together to what they would get by the extra produce which is expected to be obtained in consequence of the destruction of game by the occupiers. Hence

—sport being a purchasable commodity—the *prima facie* inference is that the aggregate of utilities actually obtained from the land bears a higher value than the material produce to which this legislation sacrifices it: so that the change is no more beneficial to production (as I conceive it) than the conversion of valuable vineyards into less valuable cornfields. It is, in fact, rather an interference for distribution—as it tends to cheapen the commodities consumed by the poor, at the expense of the luxuries of the rich: though its importance from this point of view is not likely to be very great, under the existing conditions of communication and transport, provided the freedom of trade is maintained unimpaired¹.

While considering the case of game, we may note the legal prohibition of killing certain kinds of wild animals during certain parts of the year: i.e. chiefly during the breeding season, when the destruction of future supply that would result from any given amount of slaughter would be much greater than at any other time. This interference exemplifies the theoretical case noticed at the close of the second chapter of this book: the case, that is, of restrictions to which it would be the interest of all—or almost all—to conform, provided that each could rely on their observance by all others, but which it would be very much the interest of individuals to break if they were imposed by mere voluntary mutual agreement, without stringent penalties for non-observance.

So far we have considered Government as interfering with private management of land by way of regulation. But modern governments have also exercised an important and apparently successful influence on agriculture by carrying out certain extensive improvements of land (such as reclamation with drainage or irrigation) or by assisting private associations for this purpose with loans of capital, guarantees of interest, and

¹ It may be observed that the obvious effects of such a measure on population are favourable, as it tends to primarily increase that part of the gross produce of land that is consumed by the working class: but its ultimate effects are often rather hard to estimate, as we have to take into account the loss to the agricultural producers in any district that would result from materially diminishing the inducements offered to the rich to reside in the district. In an extreme case, no doubt, a general passion for sport among rich men might cause a serious and extensive depopulation of certain regions.

powers of compulsory interference with recalcitrant landowners¹. This kind of interference seems to be theoretically defensible,—on the principles previously laid down in respect of railways, &c.—wherever there is a decided advantage in carrying out the improvements in question on a single system over a large area. Again, as I have before said, there seems to be no special reason why government should not carry on the business of lending money to individual landowners, on certain conditions: in the chief cases, however, in which operations of this kind have been successfully undertaken by European governments in recent times, the interference—though quite defensible from the point of view of production—has had so markedly a distributional character, that I have thought it more appropriate to reserve it for a subsequent discussion.

Before concluding this chapter I may perhaps observe that governmental interferences of which the primary intention had no relation to the production of wealth have often had important productional effects, which a statesman ought carefully to estimate in considering their expediency. Thus (e. g.) the restrictions placed in the English Factory Acts, on the labour of women and children, in order to prevent deleterious effects on their health, have practically had the effect of reducing the normal day's labour of male adults in most of the branches of industry to which they have been extended. And in the succeeding chapters in which we shall be considering measures designed to render distribution more equitable or more economical, we shall find that the chief objections to such measures are drawn from the bad effects on production which are found or believed to be inseparable from them. On the other hand it should also be observed that the interferences to promote production which we have discussed in this chapter become in effect interferences with distribution, so far as the gain resulting from them accrues to particular classes in the community, or the expense they involve is similarly specialized in its incidence. This last remark applies also to the operations of government discussed in the preceding chapter. We shall have occasion hereafter to notice some cases in which this consideration becomes important.

¹ In Prussia about £500,000 sterling was voted for land improvements between 1850 and 1867.

CHAPTER V.

PROTECTION.

§ 1. I NOW pass to consider the question of Governmental interference, by means of import duties, for the protection of native industry. Regarded from the statesman's point of view, in relation to the circumstances of a particular country at a particular time, this is a question of much complexity and intricacy, requiring a precise ascertainment of facts and a careful forecast of political as well as economic consequences, such as it is quite beyond the scope of the present work to attempt. But the general economic principles that ought to be applied in any such practical reasonings are not, I conceive, open to much dispute, if only they are stated with due caution; and it seems to me the more desirable that they should be clearly apprehended, because what may be called the ordinary "moderate" view on the subject—held by practical persons who wish to avoid both extremes—is in my opinion a curious inversion of the truth, at least on the practical issue most commonly raised. The moderate view is that all protection is theoretically wrong, so far as purely economic considerations are concerned; but that practically a little protection here and there does more good than harm to industry owing to influences which abstract theory overlooks. I hold, on the contrary, that when the matter is considered from the point of view of abstract theory, it is easy to show that Protection, under certain not improbable circumstances, would yield a direct economic gain to the protecting country: but that from the difficulty of securing in any actual government sufficient wisdom, strength, and singleness of aim to introduce protection only so far as it is advan-

tageous to the community and withdraw it inexorably so soon as the public interests require its withdrawal, it is practically best for a statesman to adhere to the broad and simple rule of 'taxation for revenue only'—at any rate in a free community where habits of commercial enterprise are fully developed. I will grant that *permanent* protection, regarded from a cosmopolitan point of view, is absolutely condemned by economic theory, so far, at least, as the production of wealth is taken as the end; that is, I will grant that the permanent stoppage of a channel of trade which free competition would open, could not tend to increase the wealth of the industrial society formed by the aggregate of nations whose trade is thus restricted—supposing such nations to be composed of "economic men." And the same might be said, even from an exclusively national point of view, of any permanent protection that completely stopped trade: though, as we shall see, cases are possible in which taxes *partly* protective would tend to be advantageous to the protecting nation for an indefinite period. What, however, a statesman is usually called on to consider is merely *temporary* protection in the interest of a particular nation; and to affirm sweepingly that this is "opposed to sound economic doctrine" appears to me a simple and palpable blunder. I have already indicated in the preceding chapter the most important class of cases in which such protection is economically legitimate: but the importance of the subject renders it desirable to exhibit their characteristics with somewhat more detail and precision. In doing this, it is very important to keep clear the distinction just taken between the *national* and the *cosmopolitan* points of view; and though the former is the one which we for the most part adopt in practical discussions, it is most convenient theoretically to consider the question first in its cosmopolitan aspect, as being the less complex.

To keep this aspect most easily before the mind, I will take my illustrations—though they must be regarded as purely hypothetical—from a country sufficiently extensive to render the economic considerations in favour of protection *within* it of some practical importance. Suppose then that a trade is at present carried on within the United States—let us say, between Pennsylvania and Michigan—in which Pennsylvania sends

manufactures to Michigan in exchange for corn: and consider under what conditions it will be for the advantage of the United States as a whole that similar manufactures should be established in Michigan. For simplicity, we will suppose in the first instance that there is no material difference in the average returns to labour (of the same quality) and capital in the two districts respectively; and that the new manufactures can be established out of floating capital previously existing or newly created in Michigan. It is evident, then, that the change in question will be economically advantageous on the whole—apart from any loss incurred while it is taking place—if the saving it causes in the cost of carriage of corn and manufactures is not outweighed by a loss of some other kind. And it seems likely that this will be the case, if Michigan is in respect of natural resources not materially less adapted for the manufactures in question than Pennsylvania, provided (1) that its superiority over Pennsylvania in the production of corn falls decidedly short of the degree that would render it profitable for the latter to pay the whole expense of a trade in corn from the former; and (2) that no such advantages from division of labour would be gained by the aggregation of all the manufactures in Pennsylvania, as would materially outweigh the gain in effectiveness of Michigan labour, which may be expected to result from the new opportunities of producing profitably various kinds of agricultural produce, not well adapted for transportation, and generally from the greater variety of occupations presented in consequence of the change.

The transition itself will most probably involve some loss to the community, through the diminished productiveness of the Pennsylvanian capital that will now have to be employed in corn instead of manufactures, or through the initial disadvantages (to be presently noticed) attaching to the introduction of the manufacture into Michigan, or from both causes combined; but we may fairly assume that, in spite of this loss, there will be a net gain to the community in the long run, in the case above supposed. This being so, it is apparent that the intervention of government by protective duties or otherwise, will be needed in order to realize this gain, if the private undertaker has no prospect of securing a share of it sufficient

to compensate him for the disadvantages against which he would have to struggle, under open competition, during the earlier years of his undertaking. Many such initial disadvantages may be imagined; those which are ordinarily alleged to exist are chiefly the following :

(1) the difficulty of obtaining the requisite skilled labour without paying an extra price for it :

(2) the difficulty of establishing business connexion; likely to be aggravated by

(3) the danger of a combination of manufacturers in Pennsylvania, who may lower their prices temporarily to ruin their rivals in Michigan :

(4) the difficulty of effecting simultaneously all the industrial changes required for the commercial success of any one branch of manufacture; (e.g.) the manufacturers in Michigan may lose by having to obtain instruments or materials from Pennsylvania or some neighbouring region, while yet Michigan may be no less well fitted for the production of such instruments and materials.

If on these or other grounds the Michigan manufacturer would have to incur a considerable temporary loss, it is easy to show that this may not be adequately compensated by the share he could secure of the subsequent gain to society, when the manufacture is firmly established. For this gain will consist chiefly in the saving of the cost of transport of manufactures; but of this he is only likely to secure a portion for a short time; since, after he had overcome his initial disadvantages, he would probably have to transfer a part of the saved cost to the consumer in lowered prices, in order to drive the Pennsylvanian manufacturers out of the Michigan market; and he would only enjoy his remaining extra profit for a short time, before it would begin to be reduced by the competition of new men free from the burden of the initial disadvantages.

Under these circumstances, the imposition of a protective duty on manufactures in Michigan for a certain time, sufficient to induce private capitalists to undertake the manufacture, may be a profitable outlay for the community as a whole, very much

resembling the payment of guaranteed interest on the capital of a new railway; except that in the case of a protective duty the outlay is incurred by the consumers of the article protected, and ought to be considered, in the adjustment of taxation, as a special tax on this class of persons.

So far we have been considering temporary protection as a means of introducing an advantageous change in industry. But it is theoretically possible that it may be similarly useful to prevent an inexpedient change. It is conceivable that under open competition a certain industry—e.g. wheat-growing—established in one district (M) may become temporarily so unprofitable as to be abandoned, in consequence of an important advantage enjoyed by the corresponding industry in another district (P); while at the same time this advantage may be so transient,—as for instance if it consists in a natural fertility that tends to be rapidly exhausted—that after a very limited period the same industry will tend to be revived again in M. In this case it is manifestly possible that the loss to the community through the waste of capital involved in the two changes may outweigh the gain through the greater cheapness of the products of the industry during the interval between the changes. This case, however, differs from that previously discussed; inasmuch as if it would be on the whole profitable to P and M together to maintain the industry by protection, it would equally be the interest on the whole for the individuals whose capital is invested in it to go on working at a loss for the limited period supposed; so that the only general ground here for governmental interference would be the inability of individuals to procure the requisite capital. It may be added that, actually, the difficulty of definitely forecasting future changes of industry would at best render this application of protection a highly speculative employment of social capital.

Let us now vary our fundamental hypothesis in one important point; let us suppose the returns to labour and capital materially different in the two districts. Under these circumstances it is undoubtedly true, as Protectionists urge, that it may be unprofitable for individuals in M to carry on a given branch of production, even when its cost,

measured in labour and delay, would be less in M than in P. But we cannot argue from this that the labour and capital, which might be employed in this manufacture more productively in M than in P, might not be employed still more productively in M in some other kind of industry: and therefore so far as it constitutes a *primâ facie* ground for governmental interference in the interests of production, it is for interference to promote the transfer of labour and capital from P to M, rather than to change the employment of the existing labour and capital of M.

Let us now consider how far the arguments previously given in favour of protection are strengthened or otherwise modified, if we suppose districts P and M to belong to different nations. Here I may begin by noting that protectionists are apt to treat the third of the above-mentioned initial disadvantages of manufacturers who start in a new place—viz. that arising from the hostile efforts of existing manufacturers—as though its operation depended on a difference of nationality between the two groups of producers. This view seems to me mainly due to the rather misleading habit of speaking, in discussions of international trade, as if the processes of industry were carried on by “England” and “Germany” or “America.” Hence when the self-interest of English manufacturers prompts them to undersell competitors in the United States, the procedure is not unnaturally regarded as a kind of commercial war between the two countries; and thus the possibility of the self-interest of Pennsylvanian manufacturers prompting them to a similar procedure towards a rising rival in Michigan comes to be overlooked. So far as I am aware, the sentiment of fellow-citizenship is not strong enough to prevent proceedings of this kind, within the limits of the same nation, whenever the required combination among manufacturers is practicable: and this would seem, *ceteris paribus*, to be more likely to be practicable for the manufacturers of a province than for those of a whole nation. The difficulty, however, of getting at first equally efficient labourers, seems likely to be greater where the manufacture has to be introduced in another country: though this, again, will vary very much according to the situation of the two countries, and the languages spoken in

them¹. On the other hand the disadvantage due to the difficulty of obtaining connexion is likely to be somewhat less for producers starting in another country—though the difference is probably not very important.

On the whole, I think that—if the practical arguments against *interprovincial* protection are so strong that no serious party of protectionists have anywhere maintained that it would be for the good of their country as a whole to introduce it,—we may safely take it as practically certain that *international* protection is not likely to promote the common economic interests of the aggregate of nations affected by it.

§ 2. It is, however, a very different question whether it is likely to promote the interest of the nation protecting: since here a new and important consideration comes in,—viz. how far a share of the loss involved in protection can be thrown on the foreign producers on whose products the protective duty falls. It is obvious that this result will be *primâ facie* attained so far as the reduction in the demand for the taxed foreign products tends to lower their price and causes them to be sold in the protecting country at a rate less than their previous price *plus* the import duty. Free Traders are of course right in pointing out that so far as this is the actual effect of import duties, such duties do not also fulfil their supposed primary end of protecting native industry; since to whatever extent the foreign products are still purchased, to that extent the native products are not encouraged. But this in no way proves the inexpediency of the duties in question, since they may very well give adequate encouragement to native industry without completely excluding foreign products: and it cannot be an objection to them from a purely national point of view that a part of their effect is merely to levy a tribute on foreigners for the national exchequer. A simple case will show how a duty may at once protect the native manufacturer adequately and recoup the country for the expense of protecting him. Suppose that a 5 per cent. duty is imposed on foreign silks: and that in consequence, after a certain interval, half the silks consumed

¹ It is said to be often easier to get labourers to emigrate from a given part of Great Britain to America, than to another part of their native island.

are the product of native industry, and that the price of the whole has risen $2\frac{1}{2}$ per cent. It is obvious that, under these circumstances, the other half which comes from abroad yields the state 5 per cent., while the tax levied from the consumers on the whole is only $2\frac{1}{2}$ per cent.; so that the nation in the aggregate is at this time losing nothing by protection except the cost of collecting the tax, while a loss equivalent to the whole tax falls on the foreign producers.

It may be replied that the reduction in the foreign producers' profits which must occur in the case supposed will drive them from the industry in question, until either the price rises again or the protecting country obtains its whole supply from native sources: so that the 'tribute' obtained by a protective duty will necessarily be transient. And no doubt this result will tend to be brought about in course of time, if the producers in the foreign country are competing freely and on equal terms. But, firstly, the protection that we are considering is supposed to be merely temporary: so that even a temporary sharing of the expense of it by foreign producers may reduce the burden of it to an important extent. And, secondly, if the industry happens to be one in which a large amount of capital is so firmly invested that it cannot be withdrawn from it without great loss, except very gradually, the period during which the producers will submit to lowered profits will be correspondingly prolonged. And, thirdly, the foreign producers—or some of them—may be in a varying degree exempt from the equalizing effects of competition, either generally, or in the markets of the protecting country: in consequence of which they may have been making extra profits by their transactions in these markets; so that even a considerable and permanent reduction of profits may not lead them to abandon their business. This may happen in various ways—thus (e.g.) single producers, or combinations, in a country (A) may monopolize the manufacture of certain commodities sold in B; and may be thereby enabled to sell their products, if untaxed, for a price so high that even when reduced by the whole amount of a protective duty imposed in B it would still remain fairly remunerative. Under these circumstances there is no theoretical means of determining generally how far the imposition of the duty will tend, even

ultimately, to raise the price of the taxed commodities in B¹. Again, some among the producers in question may have special advantages, as compared with the rest, in producing for the foreign markets. One obvious advantage of this kind is that of situation. Thus, suppose that A has been supplied with coal from two groups of coal-mines in B, one of which is situated on the side adjoining A and the other on the side remote from it: and suppose for simplicity that the mines yield coal of the same quality at the same cost of extraction. Then if a protective duty of 4s. a ton is laid by A on imported coal, raising the price of coal in A 2s. a ton, the result may be that after a time it ceases to be profitable to send coal into A from the remoter mines of B, while it still remains profitable to send it from the nearer ones, though to a diminished extent, and for a diminished profit.

To sum up; unless foreign products are completely excluded by import duties, such duties will partly have the effect of levying a tribute on foreign producers, the amount and duration of which may in certain cases be considerable. Of course such tribute-levying will generally be a game that both countries can play at to a certain extent: hence the danger of suffering from retaliatory imposts may render protective duties inexpedient even when, apart from this danger, they would be economically advantageous on the whole. On the other hand it may conceivably be expedient for a country injured by the import duties of another to impose similar duties in the way of retaliation even when they are in themselves economically disadvantageous—just as it may be expedient to incur a greater cost in actual warfare, in order to prevent or punish more violent injuries to commerce. But to consider more particularly the conditions under which such retaliatory measures are to be recommended belongs rather to the practice of state-craft than to the Art of Political Economy.

But further, in estimating the loss and gain of protection, we have to take into account certain secondary effects of protective duties, which have not yet been considered. Supposing trade to

¹ It is even possible, in the case supposed, that the price of the taxed commodities may not rise in B at all—in which case, of course, the tax would not be protective.

be in equilibrium at the time that the demand in A for B's commodities is artificially restricted by import duties raising their price, and supposing that other things—including the demand in B for A's commodities—remain unchanged, one obvious result will be that B will import more than she exports; hence in order to restore the balance of trade, a certain readjustment of prices will be necessary by which B will in most cases tend to obtain a somewhat smaller aggregate of imports on somewhat less advantageous terms. This restriction on B's import trade may possibly not reduce materially the amount of her imports *from* A, if the commodities supplied by A are strongly demanded in B; since the price of such imports may be paid for indirectly by transferring to the merchants of A the debts of other countries who import from B. Still, as there is always some loss involved in this roundabout arrangement, the merchants of B will tend *ceteris paribus* to buy from a country to which they also sell: and therefore if the products of A are closely pressed in the markets of B by the competition of native producers, or of other countries, the protection given by A to one branch of her industry may very likely have the secondary effect of inflicting a blow upon another branch—viz. that which previously supplied the imports to B.

§ 3. So far we have not considered the effect of protection on the population of the two districts. And, as was before said, I am doubtful how far this should be taken into account in the present discussion; since in England at the present time the increase or maintenance of population within a given area is not generally included among the ends at which a statesman should normally aim. Still it may be worth while observing that in the common argument that tends to prove Free Trade advantageous to both the trading communities the question whether its advantages will be attained without some displacement of labour between the communities is often overlooked. To show the importance of this question let us take an extreme case. Suppose a country (A) so thickly populated that additional agricultural produce could not be obtained from the soil except at a rapidly increasing expense; and suppose that one-third of its actual produce of this kind—say, for brevity, its corn—is now consumed by the persons engaged in its chief branches of manufacture. Suppose that the country

having been strictly protected adopts Free Trade, and that consequently the manufactures in question are obtained at half the price from another country (B) in exchange for corn: and for simplicity let us assume that the result of the fall in price is that the same *total* price is paid for the manufactures annually consumed. What then are the manufacturing labourers thrown out of work by the change to do? The course most obviously suggested by the circumstances is that they should emigrate and supply the labour required in the extended manufactures of B, or in the newly developed trade between A and B. If they do not do this, there seems no general ground for assuming that they will all be able to find employment in A, as remunerative as that withdrawn from them. No doubt as the cost of production in agriculture may be assumed to increase continuously, a certain amount of additional labour may now be employed in agriculture which will be more productive on the whole than some of the labour employed before the trade was opened—the diminution in the amount of corn produced by each new labourer being more than balanced by the increased power of the corn to purchase manufactures. But if the additional labour is only applicable at a rapidly increasing cost, the point will very soon come at which this balance will be reversed: and it is theoretically quite possible that a portion of the labourers thrown out of manufacturing employment could not, in the present condition of industry, be employed in A in agriculture so as to yield any surplus above their own consumption. And if they could not be profitably employed in agriculture it is theoretically possible that they could not be so employed at all; so that the natural result of Free Trade may be that A will only support a smaller, though wealthier, population—the economic gain resulting from it to the community as a whole being a gain which it would require violent governmental interference to distribute so as to retain the labourers thrown out of work.

This extreme case is, doubtless, an improbable one: but it does not seem improbable that under a system of Free Trade, if any important class of producers in one of the trading countries is undersold by similar producers elsewhere, it may be impossible for some time to find employment for all of them at home nearly as remunerative as that in which they were previously

engaged—even leaving out of account the loss of acquired skill, which in some cases would constitute an important inducement to emigration.

In the above discussion I have confined my attention as far as possible to such arguments as are strictly economic and naturally lend themselves to an abstract and technical treatment. There are, I need hardly say, several other considerations both for and against protection, which would have to be carefully weighed in dealing with the question from a directly practical point of view. Among these I have already (c. iii. § 2) discussed the political advantage of rendering a nation's supply of necessaries independent of foreign trade: and it may be observed that the possibility of providing a greater variety of occupations by means of protection—which was treated as an element in the economic argument in § 1 of this chapter—may in some cases be important in other than merely economic aspects; so far as these more varied opportunities tend not merely to make labour on the whole more efficient, but also to make the labourers more intelligent, and to raise the community in the scale of civilisation. Again, the tendency of protection to keep the conditions of production more stable, and prevent the great fluctuations in local demands for labour of certain kinds which the changes of widely extended trade are liable to cause, cannot but be reckoned as socially advantageous. On the other hand, the same extension of trade tends to minimize the fluctuations in supply and value of commodities, due to unfavourable seasons or other natural causes: and the Protectionist cannot altogether evade the force of this argument by limiting protection to articles which are but little exposed to such fluctuations, or which, not being necessaries of life or industry, may be allowed to fluctuate without any serious evil consequences: since it must always be borne in mind that any restrictions on trade have an indefinite but important tendency to hamper its general development, and diminish its efficiency for rendering in time of need any services that may be required from it. And this leads me to notice another bad consequence of protection, which, though similarly indefinite, would I think be regarded by most European statesmen as a very strong argument against

it, over and above any definite economic loss that it might cause¹: viz. its tendency to impair the moral independence and 'selfhelp' of producers, by leading them in all industrial crises and dangers to look to government for aid, instead of exerting to the utmost their own foresight, ingenuity and energy. This tendency, too, would naturally—and we may say reasonably—be increased by the disturbances in industry that transitions to and from protection, or changes in amount of protecting duties must inevitably cause, however skilfully managed. Some, indeed, would go so far as to say that this danger of overrating the springs of selfhelp ought to be a decisive argument against protection, even supposing we could rely on adequate wisdom and impartiality in the protecting government—but this is a point on which my psychological knowledge does not enable me to form so definite a conclusion.

¹ I have thought it right to qualify the statement in the text, because it does not appear that either the ingenuity or the enterprise of manufacturers in the United States has been materially impaired by protection.

CHAPTER VI.

THE PRINCIPLES OF DISTRIBUTIVE JUSTICE.

§ 1. IN the preceding chapters we have considered the grounds and limits of governmental interference so far as its end is the most economic production of purchasable utilities estimated at any given time at their market value. Many, however, of the particular kinds of interference that we have had occasion to discuss are commonly recommended not from this point of view alone, but also as conducive to a better distribution of produce; whether this better distribution is expressly judged to be such because it is more economical (in the sense above explained); or whether—as is more ordinarily the case—it is preferred and commended as more “Just” or “Equitable.” On the other hand such interferences are often condemned on grounds of Justice; as involving a violation of the rights of individuals. In the following chapter I propose to discuss governmental interference with distribution—including the comprehensive schemes for such interference recommended by Socialist or semi-socialist writers—from a purely economic (or utilitarian) point of view; considering how far Individualism or Socialism may be expected to lead to most happiness, so far as this depends on the production and distribution of the produce of industry. In my view this is the consideration that ought to be decisive with the statesman and the philanthropist. But it seems expedient to clear the way for this discussion by a brief examination of other ethical views of the distribution of wealth and of the social order on which it mainly depends; since there are still many thoughtful persons who consider the present individualistic organisation of society to be abso-

lutely right, regarding all interference with private property as "spoliation," and all interference with free contract as "tyranny of the state over the individual." On the other hand there are Socialists who, with no less sincerity, pronounce private property generally—or private property in the instruments of production—to be "robbery," and regard the wages-contracts resulting from it as the manifestation of the "enslavement of labour by capital."

The opposition between the two views is violent and at first sight irreconcilable; I think, however, that it will be found possible to reduce it materially by careful consideration of the opposing doctrines, and so ultimately to find a common ground on which a profitable discussion may be conducted between them.

It may seem that such a discussion has not sufficient bearing on practical problems to be appropriately included in this part of my treatise. And no doubt the proposal to abolish private property—even if limited to the instruments and materials of production—cannot be said to come as yet within the range of a statesman's consideration; except as an actual or possible source of dangerous and disordering agitation among the poorer classes. But the proper application of the notions "just," "fair," "equitable," &c., to different parts of the existing distribution of wealth is undeniably a matter for practical consideration; since the demand that wages, profits, rents should be "fair" is continually made and approved by large sections of the community who would shrink from any scheme of wholesale interference with the rights of property. And we shall, I think, obtain a clearer and fuller view of the general principles of Justice or Equity which are implicitly assumed on one side or another in the discussion of such demands, if we examine the broad issue between the individualistic ideal of society, approximately realised in modern civilised communities, and the various socialistic schemes that have been constructed with the view of remedying its alleged injustices.

We may begin by removing a complication, by which the argument is sometimes confused, arising from the fact that the individualistic system is in possession of the field. Some persons, if the abolition of private property were proposed, would

condemn the proposal as unjust, merely because the institution actually exists and has always existed from time immemorial. Reflection, however, would probably convince them that this position is untenable; since they would not deliberately maintain either that no established social order could be unjust or that if unjust it ought nevertheless to be perpetual. That any removal of legalized and long-standing social injustices should be managed with as much regard as possible to the legitimate expectations of the persons profiting by such injustices would be admitted by all reasonable persons; and more than this would hardly be demanded by any in the case of such generally approved changes as the abolition of slavery, serfdom, absolute despotism, or oppressive oligarchical privileges. Thus our question must clearly be whether the institution of private property is to be ranked with these; i.e. whether it is from an abstract point of view, just or unjust. It would not even be contended, in the parallel cases just mentioned, that *full* compensation ought to be given to the persons damaged by the changes; for such compensation as would secure them advantages equal to those that they had lost would often be obviously impossible. All that can be said is that the compensation for the disappointment of legitimate expectations should be as nearly adequate as the circumstances of the case allow.

On the other hand we may equally neglect the argument that the existing inequalities in the division of property have had their origin in injustice; even if we grant that this is largely true in the case of the nations of modern Europe. For to disturb expectations based on ages of orderly possession, merely in order to remedy such ancient wrongs is not defensible on any even plausible principles of jurisprudence or morality: such a measure could only be *prima facie* justifiable if it led to the final substitution of a more equitable social order. Any plausible attack on private property must be based on objections not to its origin, but to its actual operation; and similarly, if the absolute justice of the institution is to be maintained, it must not be merely because it actually exists, but because it is abstractly reasonable.

§ 2. Let us ask, then, on what grounds it can be argued that individuals have an inalienable right of property, which must

avail always and everywhere against all considerations of equity or expediency that may be urged in favour of Socialistic schemes?

The most received positive answer to this question is, I think, that which treats the full right of private property—including the right of freely disposing of it by exchange or otherwise—as an indispensable element of the right to Liberty. What a Just social order (it is said) secures to individuals is Equal Freedom; whatever inequalities in the enjoyment of the material means of happiness may actually result from the exercise of this Freedom are perhaps to be deplored and voluntarily alleviated, but certainly not to be forcibly prevented by the action of Government. This Equal Freedom, then, is held to include the liberty of securing to oneself and transferring to others the sole use of any material things not hitherto appropriated.

Against this interpretation of Social Justice considerations have often been urged which may be summed up in the following dilemma. If, on the one hand, we mean by Freedom simply the antithesis of physical coercion, it does not appear that the most perfect realisation of the 'Freedom of each so far as compatible with the Freedom of all others' would include the establishment of private property at all: it would be strictly limited to protection of the individual from interference while actually using any portion of material wealth, in the same way as he would be now protected while using roads, commons, &c. So much Freedom as this is obviously compatible with the extremest Communism. If, on the other hand, we extend the notion of Equal Freedom to include equal opportunity for gratifying desires, then it does not appear how Equality of Freedom can be realised so far as any appropriation is allowed which renders things of the kind appropriated unattainable, or more difficult of attainment, by others. But, if this be granted, since land is a commodity of this kind—at least in all but very thinly peopled societies—and since most other property has come from appropriated land, the supposed basis of the right of private property can give but very little support to the institution in an advanced stage of social progress.

Similar difficulties arise if, instead of the more general

“realisation of Freedom”, the special principle that “every man has a right to the produce of his labour” is proposed as fundamental. Human labour is obviously not the cause of the *matter* of any material product, but only of its form; therefore if a man is to have right of property in the product he must have already been allowed to appropriate the material; and this preliminary appropriation will require justification. To say that he has laboured in seeking it is a manifest straining of the principle that we are considering; since, as was before said, land, the grand primary material or natural instrument of that agricultural and extractive labour which is the prerequisite of all other productive work, is not something which a man would have to labour seriously in seeking, if appropriation in land had not already been allowed; and at any rate the reward of the first finder’s labour cannot equitably involve an uncompensated diminution of the opportunities of other seekers. All that can be urged is that the easiest and most obvious way of securing to a labourer the results of his labour, is to allow him to appropriate the material to which it is applied; and that this is not substantially unfair to other individuals, because though they find the land appropriated, they are placed in a better position than they would be in if there had been no appropriation. Now it is, of course, incontrovertible that labour in the aggregate has gained immensely by the accumulation of the stored results of previous labour; and that we must include in these accumulations a considerable portion of the utility and value which the land of any civilised country has gradually acquired in the course of its history. And as for what remains of the value of the land—the increment not due to the labour spent on it—it may be plausibly maintained that the community would have lost a more than equivalent amount, from the consequent diminution of the inducements to industry, if complete private ownership of land had never been allowed. At any rate it is undeniable that existing labour, taken in the aggregate, gains more through the accumulation of the results of previous labour than it loses by finding the land appropriated.

§ 3. But granting that the encroachment on the opportunities of existing labourers, involved in private property, is adequately

compensated to such labourers in the aggregate; the question still remains whether the individualistic system of private property and free contract tends to give particular labourers what their services are fairly worth. This is the contention of advocates of *laissez faire* generally: and it certainly seems to me that the prevalent acquiescence in the results of competitive distribution—at least among persons whose principles of conduct are not consciously utilitarian—is largely due to the more or less definite conviction that free competition affords the best realisation possible, in a community of human beings, of the principle that “every man should have the opportunity “of obtaining a fair return for his labour.”

Now the strength and importance of this conviction has, I think, been underrated by those economists (chiefly English) who have sought to exclude considerations of “fairness” altogether from the scientific treatment of the problem of distribution. For the conclusions of economic science have always been supposed to relate ultimately—however qualified and supplemented—to actual human beings; and actual human beings will not permanently acquiesce in a social order that common moral opinion condemns; and if common moral opinion is tolerably satisfied with the competitive system, this is surely because it is not conscious of any wide and glaring divergence between the distribution of wealth which the moralist approves and that which the economist assumes. Political Economy, in fact, has importantly modified popular ethical conceptions, by defining the common moral ideal of equity in exchange where pre-economic morality had left it vague and indeterminate. The pre-economic morality, whether of the vulgar or of philosophers, considered services and products as possessing “intrinsic “worth;” and the same conception still governs the moral judgments of the vulgar, even in the present stage of economic culture—thus, one continually hears thrifty housekeepers agreeing in moral disapprobation of the present race of servants, for their persistence in demanding “more than they are worth.” But reflection soon shows that the ordinary estimate of this intrinsic worth is merely dependent on custom and habit; so that some other standard of value has to be found, unless we are prepared to condemn any deviation from custom as

extortionate. And this no one in modern times is prepared to do: extended historical knowledge has shown us the wide variations of such customs from place to place, and the changes that time has continually wrought in them; and has thus irresistibly demonstrated the irrationality of setting up as a final standard the custom of a particular age and country. In this difficulty the economic ideal of free competition has been accepted as supplying the required standard; so that the one price, which competition tends at any time to fix as the market-price of any kind of services, has been taken to represent the universal or social—and therefore morally valid—estimate of the “real worth” of such services.

Now, if the theory of distribution expounded in the preceding book be correct, it is in a sense true that under free competition every commodity tends¹ to be sold for what it is worth; but only in a certain special sense which requires to be carefully distinguished and defined. The competitive remuneration of the individual's service to society does not tend to measure his share of the *total* utility of the kind of services he renders—for in the production of necessaries this might be infinite; since the entire subtraction of the labour used in this production, if it could not be replaced, would obviously destroy the society—but it tends to measure its *final* utility; that is, what the community would lose by the subtraction of a single individual's services. This view at once explains and is illustrated by the advantage which under certain circumstances a class of labourers may conceivably obtain by a combination which enables them to sell their services in the aggregate; for they thus force society to reckon the total utility of this aggregate, which may be indefinitely greater than the sum of the additional utilities of the portions supplied by the individual labourers, estimated separately. And it would seem that when any set of scantily paid workers complain of their wages as “unfair,” this discrepancy between

¹ I have not thought it worth while to draw attention again to the not uncommon conditions under which this tendency does not actually take effect. Some of these conditions, and the consequent difficulties in determining what is a ‘fair contract’ in particular cases, will be discussed in the concluding chapter.

total and final utility is often vaguely present to their minds; they consider the great importance to society of the aggregate of the services of their class, rather than the comparatively trifling importance of the services of any individual worker. More frequently, perhaps, the complaint expresses simply the moral dissatisfaction with the proportionment of reward to final utility, which arises when the causes that influence the latter are clearly understood and carefully considered. If a man is as industrious to-day as he was yesterday, it seems hard that he should suffer because some unforeseen decrease in the demand for his commodity, or increase in the supply of his particular kind of labour, has reduced the final utility of his services. If, however, we reject the measurement of "worth" of labour by final utility, what other standard can we take? To determine the reward of any species of labour by estimating the loss which the subtraction of the whole aggregate of such labour would inflict on society is obviously futile and impracticable. The production of necessaries and that of luxuries would from this point of view be incommensurable; all, if permitted, would choose the former; and no reason could be given for selecting some rather than others for this high function and remuneration.

In this perplexity it may perhaps be suggested that we should measure desert not by achievement, by the utility rendered to the recipient of a service, but by the effort of the worker. And certainly this measurement is more in harmony with the general notion of good and ill desert, outside the region of exchange: we generally consider that the merit of a deserving act lies in its intention rather than its result, since this latter may be materially changed by causes for which the agent cannot be made responsible. But the attempt to apply this principle to the distribution of social produce involves us in difficulties that seem even theoretically insuperable. For not only shall we have to abstain from rewarding physical strength and quickness, and ingenuity, since these are qualities independent of voluntary effort; but we shall find it hard to justify the allotment of higher remuneration to those who have exhibited energy and perseverance, as we cannot prove that these qualities, like the former, are not merely

gifts of nature, rather than manifestations of the free choice of the individual agent. Thus practically on this line of argument the principle of rewarding desert will find no realisation, through our scrupulous anxiety to realise it exactly! Now, whatever may be said, on the principles of necessarianism in favour of practically discarding the attempt to reward Desert¹, it must be admitted that this conclusion is not in harmony with our common notions of Justice. Still, the reasoning which has gradually led to this conclusion seems to shew that the demand for greater equity in distribution can only be practically interpreted as a demand that differences in remuneration, due to causes other than the voluntary exertions of the labourers remunerated, should be reduced as far as possible.

§ 4. If, then, it be admitted that 'fair wages' have to be defined, for practical purposes, as 'market wages obtained under the condition of the least possible inequality of opportunity,' it remains to consider how far such conditions may be expected to result from complete *laissez faire*. Now it has certainly been the firm and long-cherished belief of many adherents of the traditional Political Economy, that unrestricted freedom of action and contract would tend to reduce the actual and inevitable inequality of economic opportunities to the lowest attainable minimum—so soon at any rate as enlightenment should be sufficiently diffused by means of elementary education and the spread of cheap means of obtaining information by newspapers, &c. They have believed that labour thus becoming approximately mobile would flow when the demand for it—or its final utility—was greatest, nearly as easily and rapidly as water finds its own level; so that no considerable class of persons would for any length of time obtain, as remuneration for their labour, materially more or less than the market-price of the most useful services that nature and their own or others' labour and care had qualified

¹ The reconstructors of society who discard Desert seem driven to adopt as their principle of distributive justice either simple Equality, or Equality modified by differences of Need. In the next chapter I have discussed briefly the communistic institutions in which either of these views finds its natural development; but I have not thought it fitting to introduce them here, as I do not consider these principles to be even vaguely implied in the current notions of "just" or "fair" distribution.

them to render. They have admitted that very great inequalities of income, due to inheritance, would probably continue to exist; but they have thought it not unjust that *A*'s income should be augmented by the results of his ancestors' labour and care, whether in the form of material wealth or personal aptitudes—assuming, of course, that such augmentation did not tend to make *B*'s income less than it would otherwise have been.

Those who hold, on the other hand, that this view of the tendencies of *laissez faire* is far too optimistic, urge chiefly the following objections. In the first place, it is impossible to prevent the effects of monopoly, especially monopoly resulting from combination, from modifying and disturbing to an indefinite extent the effects of free competition, without placing the freedom of exchange and association under restraints of a kind that the advocates of *laissez faire* could not consistently recommend. And we may add that the attempt to impose such restraints, even if made in the style of the most despotic of modern Governments, could never have more than a very imperfect and unsatisfactory kind of success. It could at most only prevent express and open combination; but, as we have before observed¹, the effects of monopoly may be largely brought about by tacit combination, which is obviously easier to the rich few than to the many poor, and which, therefore, it would be highly objectionable and invidious to favour indirectly by suppressing the only force that could effectively counteract it. On the other hand combination can have no general tendency to bring about a just distribution of produce, according to any recognised view of justice; since (as we have seen) the share of produce that a successful combination, controlling the whole aggregate of some socially indispensable kind of labour, might exact is theoretically limited only by the condition of leaving the necessaries of existence to the rest of the community; while, again, a struggle between opposing combinations can only be terminated by an arbitrary compromise.

There is, indeed, one way in which the State may effectually prevent the disadvantageous results of monopoly without vexatious and inquisitorial legislation; viz. by taking into its own hands a business that would otherwise fall into the hands of

¹ Book II. c. x.

private monopolists; since it is thus enabled both to manage the business in the interests of the community, and to secure to the public purse whatever profit it is possible and expedient to make out of it. In preceding chapters we have seen that the absence of any general coincidence between the interest of the monopolist and that of the community, as regards the extent and quality of the commodities supplied by him, constitutes a strong argument for this kind of governmental interference from the point of view of production; we have now to note further that the same measure is to be recommended as tending to remove an important source of inequality in distribution. Against these two considerations we have, of course, to weigh the general drawbacks of governmental as compared with private management; as these, in certain cases, might be so great as to render the loss to the community through deteriorated production more important than the gain in equity of distribution: such a comparison, however, cannot be profitably made except in concrete cases, as its results will vary very much both as regards different countries and different businesses in the same country.

But further, the critics of *laissez faire* also lay stress on the growing element of fluctuation and uncertainty in the relations of demand and supply of commodities, in consequence of the more extensive organization of industry through international exchange. In this way, they maintain, the complexity of the causes affecting any worker's remuneration tends to increase in a far greater ratio than his intellectual resources for forecasting their effects; so that the element of 'desert' in his gains and losses of income tends to become continually less instead of greater. The facts at present appear to bear out this view; though we have hardly grounds for predicting the continued increase of this fluctuation and uncertainty—rather it would seem reasonable to regard this increase as probably itself fluctuating and uncertain. But sudden and considerable changes in the earnings of particular classes of producers, due to unforeseen changes in the demand for (or supply of) their commodity, must be admitted to be a probably frequent incident of the world-wide extension of trade. All that can be said is that it would be impossible to discriminate in such cases between losses really inevitable and those that could have been

prevented or largely reduced by foresight, promptitude, and versatility in adapting action to changed circumstances; and therefore that government could not, without materially damaging production, successfully interfere to prevent the consequent divergences from equity in the distribution of produce.

§ 5. It is more plausible to hold that such a remedy is possible where the changes are mainly in one direction, and result in an "unearned increment" continually obtained by the owners of a certain kind of property, through its increasing scarcity in relation to the demand for it. The chief case of this is land in a country where population is continually growing thicker. It is true that the rise in the value of merely agricultural land, which the increasing demand for agricultural produce tends to bring about, may be more than counteracted by any kind of sudden and extensive improvements in production, especially by the cheapening of transport and the opening of new channels of supply through trade from abroad. But the rise of land near towns, or otherwise conveniently situated for the purpose either of building or direct enjoyment, is not on the whole affected by this cause. Hence, taking all the varied utilities of land into account, and assuming that the existing tendencies to increase of population will continue, we may confidently infer that the aggregate rental of almost all existing civilised countries will, at the close of any period sufficiently long to allow for transient oscillations, have received a considerable "unearned increment."

Now, so far as this increment can be definitely foreseen and measured, it would certainly be an important approximation to equality of opportunities if the landowners could be prevented from appropriating it by any legislation not otherwise inequitable. It should, however, be observed that if the landowner has no claim to the portion of increased rent that is not due to the labour or forethought of himself or his predecessors in ownership, no other individual member of the community can urge any more claim; hence any attempt to secure any portion of this increment for the particular persons to whom he happens to have let his land, by prescribing "fair rents" below the market-rate, cannot be justified on this score. The equitable claim must be taken to be that of the community. And I do

not doubt its abstract validity: but there appear to me to be the following grave objections against any attempt to enforce it, except as a part of a much larger change, in the case of land that has once passed completely into private ownership. Firstly, we have every reason to suppose that at least a great part of the future unearned increment of rent is already discounted in the present market-price of land: and it would be manifestly unjust to mulct the particular persons who keep their wealth in the form of land, by taking from them a portion of the market-value of their property. It could only be unearned additions to the existing market-value of the land that could fairly be taken by the state—or rather whatever part of such additions could be shewn to be due to unforeseen increase of rental¹: and it seems doubtful whether this portion would be found worth the cost and trouble of taking it, even if it could be clearly separated from the *earned* increment. But further, it seems to me that in many cases this separation would not be even theoretically possible; since the increased utility and value of the land would often be found to be only *partly* unearned, as it would be due to favourable circumstances well turned to account; and in such cases I do not know how we could pronounce what proportion of the increment was to be set down to circumstances and what to the insight and enterprise of the man who skilfully availed himself of them.

The only practicable way, I think, of attaining the end in view would be for the state to assume the ultimate ownership of land generally, and reward the skill and enterprise of individuals in whose hands its value increases,—according to the method before proposed in the case of railways, &c.—by allowing them to reap the whole advantage of such increase for a certain limited period. It has been urged against this proposal that the financial operation that would be required, in order to buy back nearly the whole land of a fully occupied country from its private owners, would be beyond the resources even of England; or at least that the community would lose by the increased rate of interest that would have to be paid more than it could possibly gain by unearned increment. But this difficulty may I

¹ As we have noticed in an earlier part of this work, a rise in the selling value of land might be merely due to a fall in the rate of interest.

conceive be avoided, as Cliffe Leslie has suggested¹, by deferring the time at which the community would enter upon the ownership of the land: and hence I do not think that the proposal to "nationalise the land" could be adequately encountered by any statement of the cost and trouble of effecting the operation, if it were clearly shown that the land when nationalised would yield a greater aggregate of utilities to the community than it at present does. What we rather have to ask is whether the diminution in production to be expected from (1) the inertness and jobbery incident to public management, (2) the inevitable divergence of interests of owner and lessee respectively, and (3) the loss of the special satisfactions, and any special stimulus to labour and care, which individuals now derive from the sense of ownership, is not likely to outweigh any gain in equity of distribution; even allowing for any advantages that may be fairly hoped from governmental administration, in spite of its drawbacks—e.g. from greater economy in the collection of rents, especially of small farms, the more uniform application of principles accepted by experts, and the power of borrowing on better terms. And this question, in my opinion, does not admit of any certain general answer; though I should not hesitate to answer it affirmatively in reference to most existing communities at the present time.

§ 6. In any case the Nationalisation of the Land would involve so large a transfer of private capital to public ownership that its proposal must inevitably raise the further question whether other portions of the capital of individuals should not be similarly nationalised: especially since—in recent years at least—the loudest complaint against the existing individualistic system of distribution has related to the undue share of the produce of industry supposed to be obtained by "capital" in its competition with "labour." This complaint, as usually formulated,

¹ *Fortnightly Review*, October, 1830. Cliffe Leslie, indeed, held that the "requirements of justice and expediency would be satisfied" if it were simply enacted that all land should become public property in the year 2001. And certainly the value of what the landowners would lose in this case would be comparatively trifling; but I do not see why even this loss should be thrown exclusively on the particular class of persons who happen to own land, unless it can be shown to be on other grounds just that their share of the burden of taxation should be somewhat increased.

fails to discriminate between the two elements of the yield of capital which we distinguished in Book II. under the terms "interest" and "earnings of management." If the view adopted in the present treatise is sound, the causes that determine the amount of these two elements of "profits" are so fundamentally different, that it is necessary to consider the present question with regard to each separately.

As regards "earnings of management," we certainly found reason to believe that large capitalists engaged in business obtain on the average a larger proportional remuneration for their labour than any other class of workers. As we saw¹, this is implied in the assumption, commonly made both by economists and by practical men, that at least an equal percentage of profit is earned by such capitalists; since the labour of management certainly does not increase in simple direct proportion to the amount of capital managed. At the same time the question how far these extra earnings are to be regarded as unfair is not one that admits of a simple and decisive answer; since—where no combination or other monopoly comes in—they must be caused by the superior productiveness of businesses on a large scale carried on by individual capitalists; and this greater productiveness, again, must be chiefly due to the keener concern and more strenuous activity which men in general show in the management of affairs of which they have the sole control and reap the sole profit. On the other hand, since the amount of the employers' extra gains is caused not by the scarcity of possible employers personally qualified and willing to perform equally productive work, but to the scarcity of persons who being thus qualified and willing are enabled by the circumstance of owning capital to exert their energies in this manner; it can hardly be expected that other members of the community should acquiesce patiently in this large remuneration of the labour of capitalist employers, so far as it admits of being removed by associated action.

Hence I should refrain from condemning as unfair the efforts of labourers to reduce the profits of employers by combinations to raise wages: though, as has been already said, the principle on which such combinations proceed is one which could not

¹ Cf. *ante*, Book II. ch. ix.

conceivably be employed as a general basis for an equitable distribution of produce.

Hence, again, if any reduction in the extra earnings of capitalist employers can be effected by improvements in the management of associated capital, the resulting gain in aggregate produce tends to be accompanied by a greater approximation to equality of opportunities—at least as among owners of different amounts of capital. And from this point of view any successful and profitable extension of governmental management of industry—which we may regard as a peculiar species of associative management—would seem to be doubly desirable.

But further; we saw that it is not only the large capitalist whose services (as employer) tend to be at a scarcity price as compared with those of smaller capitalists; advantages similar in kind are possessed in various degrees by capitalists, or rather by the children of capitalists, of lower grades in the scale of wealth—including those who possess “personal capital” in the knowledge and skill acquired by industrial or professional training. These advantages are realized, whenever the differences in the average remuneration of different grades of labour are in excess of what would amount to ordinary interest on the additional outlay required for sustenance during an additional period of education, and for the greater cost of the education itself. Here again we may say that so far as the scarcities which cause these differences can be diminished or removed by governmental action that is socially profitable—as (e.g.) by a system of free or cheapened education, of which the cost would be repaid to the community in the increased productivity of labour—the tendency of such action to realise greater equity in distribution may be admitted as an additional argument in its favour.

But even if such interference could be carried to the point at which there were no differences in the remuneration of different kinds of labour except such as represented ordinary interest on different outlays of capital, the question would still remain whether this payment of interest at all is not a removable cause of inequality of opportunities; and whether, therefore, its removal would not bring about a more truly just distribution of produce. The grounds on which this has been denied by modern

Socialists are deserving of careful examination; as they have not, I think, been adequately apprehended by the individualist writers who have replied to them¹. It may be observed, in the first place, that if the market-rate of interest is attacked at all, from the point of view of abstract justice, there is no reason for stopping short of total abolition; it would be quite arbitrary to select any particular rate of interest as ideally more just than any other. On behalf of total abolition, the contention of the Socialist is that "the full produce of labour ought to go to the labourer." To this the Individualist sometimes thinks it sufficient to reply by urging the helpless state in which labour would be placed if deprived of the instruments of all kinds which constitute the main part of the real capital of the community. But this answer is not really to the point; as the Socialist can effectively rejoin that doubtless labour requires instruments, and the labour of making instruments should be remunerated as fully as any other kind of labour; but that interest is certainly not the remuneration for this labour; being in fact, as the economists of the *laissez faire* school have been especially careful to explain, payment for what Senior and others have called the "abstinence" of the capitalist; or, as I have preferred to say, for the delay that he allows to intervene between the application of the labour and the consumption of its product. The real question therefore is not whether instruments ought to be made but whether it is fair that this delay involved in making them should have to be paid for. On the Individualist side it is urged with truth that Labour has gained on the whole by the delay to a far greater extent than is represented by the interest paid. But the Socialist can answer that the private ownership of 'producers' as distinct from 'consumers' wealth is not a necessary condition of this gain. He can urge that if the community once for all took possession of the producers' capital that is now in private hands, all future accumulations of such capital might go on just as they would do on the existing system, assuming that the community would consent to devote as much labour as at present to the production

¹ I ought to say, on the other hand, that the Socialist arguments that I have seen have been wanting in clearness of distinction between interest and that extra profit of employing capitalists that we have just been discussing.

of remote utilities; so that, even supposing the *present* interest to be paid to the dispossessed owners of the capital already accumulated, the labourers might still divide among themselves the increment of produce continually accruing from new accumulations of capital. In short, all the 'saving' required *could* be done without being paid for, if it were done by the community previous to the division of the produce.

It must be admitted, I think, first, that the social accumulation of instruments might conceivably be carried on by the community, and without any payment of interest; and secondly that there is no principle of abstract equity which renders it morally obligatory to carry it on as at present, by first allowing individuals to divide up the whole produce of social industry, and then promising them future payments if they will allow a portion of their shares to take the form of fresh instruments. Nay I should go further and say that if the former method of providing for the progress of industry could be trusted to work, without any counterbalancing drawbacks, the perpetuation of the inequalities of distribution that we see to be inevitably bound up with the existing system would be difficult to reconcile with our common sense of justice. And even assuming, as Socialists usually do, that it would be necessary for the complete attainment of their end to prohibit all lending of money at interest, I see no reasonable ground for treating this prohibition as absolutely unjust. If the interference with freedom involved in appropriation of land to individuals may be justified by the gain to production that it has caused, this other interference might equally be justified if without impairing production it tended to bring about an adequate improvement in distribution. Nor do I think that the difficulties of transition from the one system to the other, or the inevitable disappointment of expectations involved in it, would necessarily be more intense—though of course they would be indefinitely greater in extent—than those which in the course of modern history have actually attended the abolition of slavery in our colonies, of serfdom in Russia, or of oppressive feudal privileges in other European States. I do not mean to imply that the transition to Socialism is to be classed with the changes just mentioned, even if it be regarded merely as a distant stage of social progress; but in

urging the reasons for not so regarding it we have to pass—as in the case of the remedies for inequality of opportunity that we have before discussed—from the point of view of distribution to that of production; and in so doing we necessarily shift the controversy from the tribunal of abstract Justice to one where utilitarian or, as I have called them, “economic” considerations are taken as decisive.

CHAPTER VII.

ECONOMIC DISTRIBUTION.

§ 1. IN the preceding chapter we have considered the question of governmental interference with a view to a more equitable distribution of produce. I now pass to consider how far such interference is desirable on economic grounds: that is, as was explained in the first chapter of this Book, in order that a greater aggregate of utility or satisfaction may be obtained from the produce of the labour and capital of the community. It may appear that there is no material discrepancy between the practical conclusions to which we are led by reasoning from either point of view: but the lines of reasoning themselves are widely different. So far as we aim at realising Justice or Equity—according to the interpretation of these notions that has been chiefly discussed in the preceding chapter—the proportionment of the individual's share of produce to his Deserts is the primary end to be sought, and the removal of inequalities only as a means to this; that is, only so far as these inequalities are due to other causes than the different worth of the exertions unequally remunerated. Whereas from a purely economic point of view the relation of Desert and Equality is the reverse; a more equal distribution is—subject to certain important qualifications that will be presently stated—more economic: and though the principle of rewarding desert remains, in my view, paramount, it is rather as a stimulus indispensable to the most economic production, which thus presents itself as a condition by which all efforts to make distribution more economic ought to be confined. The distinction is perhaps rather formal than material; but it is

necessary to make it clear, in order that the relation of the present to the preceding chapter may be understood.

The *prima facie* ground, then, on which the interference of Government with the distribution of produce that results from the individualistic organisation of industry appears economically desirable, is the great and ever increasing inequalities in income to which this organisation leads. The common sense of mankind holds these inequalities to be objectionable; implicitly adopting, as I conceive, a certain view of the relation of wealth to happiness which it will be well to state explicitly, in two propositions laid down by Bentham.

These propositions are (1) that an increase of wealth is—speaking broadly and generally—productive of an increase of happiness to its possessor; and (2) that the resulting increase of happiness is not simply proportional to the increase of wealth, but stands in a continually decreasing ratio to it.

The former of these propositions will be thought by many to need no support; considering the vast and varied aggregate of widely felt desires which wealth supplies the means of gratifying. Still it is notorious that it has been roundly denied by a large number of thoughtful persons. Indeed, as was before observed¹, even the author of the *Wealth of Nations* has expressed himself with remarkable decision in the opposite sense. I think, however, that the sentimental optimism which held that happiness is equally distributed between the palace and the cottage—with a preference, if at all, in favour of the cottage—has wellnigh vanished before a more careful and impartial study of the facts of social existence. At the present day, even those who most warmly assail Political Economy on the ground of the exaggerated importance which it attaches to wealth, do not usually go so far as to maintain that increase of wealth is not important for the individual and for society so far as it can be attained without any sacrifice of other sources of happiness. All would admit that there are many rich individuals who would be happier on the whole if they were poorer; and, again, that the immediate effect of a sudden and considerable increase in the wealth of certain sections of the poorer classes might very likely be a diminution of happiness, on account of the increase of pernicious

¹ Introduction, c. II. § 3.

indulgences that it would bring with it. But, making all allowance for such partial or transitory exceptions, it remains true that the practical reasonings of the great mass of mankind—whether for themselves or for others in whom they are individually interested—proceed on the assumption that it is an advantage to be richer; and, further, that the judgment of the most highly cultivated, scrupulously moral and sincerely religious persons—as expressed in their conduct—does not diverge materially from that of the vulgar in the matter. The *élite* certainly disagree very much with the vulgar as to the real value of particular purchasable commodities; but they do not practically doubt that additional control over purchasable commodities generally is an important gain to an individual who obtains it. A man who chose poverty for himself, except for some manifest special and unpurchasable advantage, or at the manifest call of some special duty, would be deemed eccentric: a man who chose it for his wife and children would be generally thought to deserve a harsher name.

On the other hand few, I conceive, would estimate the advantage of additional wealth so highly as even to dispute the second of Bentham's two propositions above stated, and to contend that on the average the amount of satisfaction derived from wealth tends to increase in simple proportion to the increase of the wealth itself. And from the two propositions taken together the obvious conclusion is that the more any society approximates to equality in the distribution of wealth among its members, the greater on the whole is the aggregate of satisfactions which the society in question derives from the wealth that it possesses.

Reflection, however, shews that this inference is only legitimate under certain conditions: viz. that the total amount of produce to be divided, and the number of persons among whom it is to be divided, remains unaffected by the change in distribution; and further that the change has no tendency to diminish the happiness of the community so far as it is derived from other sources than increase of wealth. These conditions require careful examination; since it will be found that under each of these heads important, if not decisive, considerations may be urged in favour of the existing inequalities of distribution.

§ 2. In the first place it is conceivable that a greater equality in the distribution of produce would lead ultimately to a reduction in the total amount to be distributed, in consequence of a general preference of leisure to the results of labour on the part of the classes whose shares of produce had increased. It may be said that we should have no ground for supposing in this case a diminution in average happiness corresponding to the diminution in wealth; since, by supposition, the increase of leisure would be chosen as likely to give more happiness than the increase of wealth. There are, however, two considerations of some weight which may lead us to doubt the soundness of this *primâ facie* view. In the first place there is a wide-spread opinion among observant persons that human beings generally have a tendency to overvalue leisure as a source of happiness. All those who maintain that riches frequently fail to bring an increase of happiness to their possessors commonly lay great stress on this tendency; they argue that the rich miss happiness largely through an undue pursuit of passive pleasures and amusements, to the neglect of those that may be derived from strenuous activity for a serious end. I am myself disposed to take this view: and I should regard it as highly probable that a sudden and large increase of the income of the poorer classes might cause them to fall extensively into similar imprudence. But further, even supposing that the diminution in their labour led immediately to a real increase of happiness through increased leisure, there would still remain the objection that it might diminish the provision against social calamities causing great and sudden loss of wealth, which is now supplied by the superfluous consumption of the rich. Such calamities whether due to natural causes, or to war, or even merely to the changes of industries and trade, may now be met by a restriction of the luxurious expenditure of the richer classes generally—through their voluntary contributions or increased taxation or both combined—by which the extreme distress that they would otherwise cause to the poorer classes may be mitigated. A community that had exchanged its superfluous wealth for greater leisure would be likely to suffer more severely under such circumstances.

But again, even supposing that the equalisation of shares

did not diminish the average activity of the workers of the community, it might still diminish the efficiency of labour through its effect on the accumulation of capital. At present, the greatest part of the saving, by which the stock of instruments in the country is continually increased and the benefits of invention realised, is made from the larger incomes of the rich: and consequently there is a considerable danger that an equalisation of incomes would lead to a decrease in the proportion of the aggregate income of the community thus converted into capital. It may be observed too that the tentative and hazardous investments, which have hitherto been necessary for the progress of industry through invention, are more appropriately made out of the savings of persons who suffer comparatively little from the partial or even total loss of their capital.

This argument, as just stated, assumes the continuance of the present individualistic organisation of industry: since under a socialistic system the accumulation of capital would be controlled by the government and would be independent of the savings of individuals. But a corresponding objection would seem to hold in this latter case: since governments have hitherto shown themselves timid and unenterprising in availing themselves of the results of invention; and there seems no reason to suppose that a socialistic government would be specially bold in trying expensive experiments.

Again, as we have already seen, experience would lead us to conclude that, even supposing the aggregate of accumulation not to be diminished by a more equal distribution of produce, still a quantum of capital made up of a number of small portions in different ownership is less likely to be productively administered than an equal quantum divided among a few wealthy owners. The small savings might no doubt be massed by association in amounts sufficiently large for the organisation of businesses on any scale that might be found most economically expedient; but theory and experience combine to shew that the keenness of concern, and the power of prompt and unfettered action, that private ownership gives would still be wanting to the necessarily salaried and controlled managers of these businesses. Unless these advantages can be compensated, to a greater extent than they have hitherto been, either by some

future development of the system of Cooperative Production or otherwise, a more equal distribution of capital must necessarily be attended with a decrease in its productive efficiency. And this conclusion holds equally whether we suppose the existing individualistic organisation of society to continue as at present, or to be wholly or partially superseded by socialistic institutions; so far as we have no ground for regarding governmental management of capital as likely to be superior on the whole to average jointstock management in the points in which the latter is less efficient than management by private owners.

The objections above stated apply with increased force, if we suppose—what experience shews to be most probable—that the increase through equalisation of the incomes of the poorer classes will cause the population to increase at a more rapid rate than at present; so that ultimately the increment of an average worker's share will be partly spent in supporting a larger number of children, and partly reduced through the decrease in the efficiency of the more crowded labour. Even apart from the dangers of diminishing resources against unforeseen calamity and checking the accumulation of capital, it seems at least highly doubtful whether a mere increase in the number of human beings living as an average unskilled labourer lives in England can be regarded as involving a material increase in the *quantum* of human happiness—but this is a question which I do not see how to decide exactly until we get some more accurate measurements of human happiness than we at present possess¹.

Finally we have to consider the importance of the social functions—over and above the economic function of employing capital—which the wealthier members of a community actually fulfil, however imperfectly and with whatever waste of resources, in their customary employment of their leisure and their luxurious expenditure. I do not now refer mainly to the function of governing—including that of giving suggestions and admonitions to government—since I take it to be a disputed question

¹ Mill and other economists who have laid stress on the expediency of limiting population, appear to me often to assume a degree of knowledge as to the amounts of happiness obtained in different classes which I do not myself possess, and do not even know how to acquire.

of Politics whether these functions in the present stage of social development may not be better fulfilled by salaried officials and professional journalists, &c. I refer rather to what may be comprehensively though vaguely designated as the function of maintaining and developing knowledge and culture. I distinguish knowledge from culture, though the latter notion would naturally include the former, because of the peculiar economic importance of the progress of science, as the source of inventions that increase the efficiency of labour. This progress in past ages has been largely due to the unremunerated intellectual activity assisted by liberal expenditure, of rich and leisured persons. At the same time it is of course conceivable that the development of knowledge should be adequately carried on—as it is chiefly in Germany at the present time—by persons salaried and provided with instruments at the public expense. And the connexion between scientific discoveries and technical inventions is now so firmly established in the popular mind, that probably even a government controlled entirely by persons of small incomes would not refuse the funds requisite for the support of the study of physical science in universities, academics, &c. The case is different with such knowledge as has no obvious practical utility, and is therefore only likely to be valued by persons susceptible to the gratifications of disinterested curiosity. Such knowledge must be ranked, as a source of elevated and refined gratification, along with literature, art, intellectual conversation, and the contemplation of natural beauty. The capacities for deriving enjoyment from these sources constitute what we call culture; they are generally regarded by persons possessed of them as supplying a most important element in the happiness of life; while at the same time, so far as we can judge from past experience, it is only in a society of comparatively rich and leisured persons that these capacities—and, still more, the faculties of producing excellent works in literature and art—are likely to be developed and transmitted in any high degree.

There seems therefore to be a serious danger that a thoroughgoing equalisation of wealth among the members of a modern civilised community would have a tendency to check the growth of culture in the community. The amount of

loss to human happiness that is to be apprehended from this effect is difficult to estimate; especially since those who estimate it most highly would probably refuse to allow the question to be decided by a mere consideration of the actual amount of happiness that culture has hitherto given. They have a conviction for which they could not give an empirical justification that a diffusion of culture may be expected in the future which has no parallel in the past; and that any social changes which cripple its development, however beneficent they may be in other respects, may involve a loss to humanity in the aggregate which, if we look sufficiently far forward, seems quite immeasurable in extent.

There are, in fact, several distinct practical questions suggested by the connexion which history shews between the development of culture and the existence of a rich and leisured class in a community of human beings. We may (1) balance the additional happiness gained to the lives of the few rich by culture against the additional happiness that might be enjoyed by the poor if wealth were more equally distributed; or (2) we may consider how far whatever happiness is derived from culture by the many poor depends at any given time on the maintenance of a higher kind of culture among the few rich; or (3) we may endeavour to forecast the prospective addition to happiness when culture shall have become more diffused, which would be endangered by any injury to its present development among the limited class who now have any considerable share in it. From each of these three distinct points of view arguments of a certain force may be drawn in favour of the present inequality in distribution of wealth.

The above mentioned appear to me the most important considerations which render it doubtful how far any great reduction of the existing inequalities of wealth is to be desired from a utilitarian or economic point of view, independently of any evils involved in the process by which the equalisation may be supposed to be effected. Any estimate of their force must necessarily be very vague and conjectural; but it seems clear that they apply far more strongly against any sudden sweeping equalisation, than they do against a more slow and gradual process of attaining the same result,—accompanied (as it natur-

ally would be) by an improvement in the average intellectual condition of the classes who would benefit pecuniarily by the equalisation.

§ 3. Let us now pass to consider briefly the methods of reducing the inequalities of wealth which have been urged by social reformers or adopted by governments. The most extreme measures which have been proposed for this end are those systems commonly designated by the terms "Communism" and "Socialism;" which involve either the almost entire abolition of private property, or its restriction to consumers' wealth, so as to leave the instruments and materials of production in the hands of the community. These terms, however, and especially the adjectives Communistic and Socialistic, are also used more widely to denote the principle of any modes of governmental interference which have for their object the attainment of the same result in a more partial way. This practice appears to me convenient; but in order to prevent vagueness it will be well to give each of the terms as precise a signification as possible, without deviating materially from ordinary usage.

Of the two terms 'Socialism' is the more comprehensive: Communism being generally regarded as an extreme form of Socialism, in which the most thorough-going antagonism to the institution of private property is manifested. It would, however, be hardly convenient to restrict the term Communism to systems involving the complete abolition of this institution; since no one, I suppose, has ever seriously recommended that (e.g.) a man should not have private property in his clothes. I think therefore that the most useful way in which we can employ the terms Communism and Communistic, without deviating materially from ordinary usage¹, is to restrict them to those schemes or measures of governmental interference for equalising distribution which discard or override the principle that a labourer's remuneration should be proportioned to the value of his labour.

The proposal to organise society on a Communistic plan, so as to distribute the annual produce of the labour and capital of the community either in equal shares, or in shares varying

¹ Cf. Mill, B. II. c. 1, where the terms are used with a denotation substantially the same as that proposed in the text.

not according to the deserts but according to the needs of the recipient, is one of which the serious interest has now passed away; though a generation ago it had not a few adherents, and was supported with earnestness and ability by more than one competent writer. And, notwithstanding what has been urged in the preceding section, the proposition that a Communistic distribution would produce more happiness than the present system, if it could be realised without materially affecting production, or removing needful checks to population, is at any rate a very plausible one. But even if it were completely true I cannot doubt that the removal of the normal stimulus to labour (bodily and intellectual) and to care, which the present individualistic system supplies, would so much reduce the whole produce to be divided, that any advantage derived from greater economy of distribution would be decidedly outweighed—even supposing that no material change took place in population. Probably few of my readers will dispute this; but I may suggest to any one who is inclined to doubt it, to compare the average energy and perseverance in labour displayed by even respectable and conscientious rich persons, even when they select their own work, with the average energy and perseverance of professional men.

If this objection be allowed to be decisive, there will be no necessity to raise the very uninviting ethical questions which would be inevitably presented by the practical problem of preventing too great increase of population in a communistic society. I do not indeed regard this problem as insoluble; but I do not see how the difficulties in which it is involved are to be overcome without such a revolution in the traditional habits and sentiments regulating the relations of the sexes as no thoughtful person could contemplate without alarm and disquiet.

The definition of Communism, as above laid down, is tolerably distinct; and it enables us to give a definite significance to the adjective 'communistic,' in its wider application to denote the tendency of minor governmental interferences. That is, we shall classify as communistic any law or institution by which a portion of the aggregate produce of a community is, by the agency of Government, distributed to individuals according to considerations of Need, without regard to their

Deserts or previous services. For instance, according to this definition, the English Poor-Law is communistic in its effects—though not, perhaps, in its principle¹. So again, public roads, parks, libraries, churches, &c., so far as they are freely used by persons who are not taxed for their maintenance, must be called communistic; though, as we shall hereafter (§ 6) notice, the bad effects of communism are thought to be avoided or outweighed in these cases.

§ 4. There is somewhat more difficulty in defining in accordance with usage the wider terms Socialism and Socialistic; since any movement for substituting governmental for private and competitive management in any department of industry is liable to be called Socialistic: while at the same time it would seem paradoxical to apply the term to such established institutions as the Post-Office, or the Mint. And even if we agree to restrict the term to those kinds of governmental intervention which not merely increase production but also equalise distribution, we still do not obtain any broad line of demarcation. For any considerable extension of the sphere of government that is really successful from the point of view of production, tends *pro tanto* to bring about the results aimed at by the advocates of more economic distribution; so far as it tends to increase the stock of capital owned by the community, and to reduce the field of employment for private capital.

This tendency may perhaps be most easily exhibited by making an extreme supposition. Suppose that governmental administration of all kinds of business were shewn to be economically superior, in a marked degree, to the present competitive management: it is obvious that the state might gradually buy up the land and fixed capital of different industries, paying for them out of the increased proceeds of its superior management; and the process, when once commenced, would go forward with continually increasing rapidity. The field of investment thus becoming gradually more and more limited, the return to capital—supposing saving to continue as at present—would probably begin to fall. ‘Spending’ would then increase at the expense of saving, and private capital would gradually diminish

¹ Cf. *ante*, chap. III. § 1, and also § 5 of this chap.

from being eaten up. It would be important that the State should purchase the land of the community, and other permanent instruments of production tending to rise in value—if there be any—at an early stage of this process: not merely to gain the unearned increment, but because, as interest sinks towards zero, the selling value of land at a given rent tends to rise proportionally. The process might conceivably go on until the payment for the use of capital, as distinct from insurance against risk, became nearly evanescent; so that only such an amount of private capital would be kept up as men would be willing to keep for security of future use and enjoyment, without any view to profit. And finally when the instruments and materials of all industries had become the property of the government, the aggregate of private savings—leaving out of account the non-usurious lending and borrowing among private persons that might still go on—could only be in the form of ‘consumers’ capital’—houses, gardens, furniture, jewels, pictures, &c. Suppose further that, at the same time, by a comprehensive system of free education, elementary, technical and professional, the present scarcity values of the higher grades of labour had been reduced, so that all such skill as average persons can acquire by training was remunerated by merely a fair return for the additional outlay or sustenance during the period of education. We should thus have arrived at something very like the ideal of economic distribution which German Socialists have put forward, without any sudden shock to the expectations formed by the present system of private property. Society would voluntarily have converted its private capital into consumers’ wealth; and, through the agency of its government would have produced for itself the public capital used in its place. The income of all individual members of the community would be entirely derived from labour of some kind—or, in the current phrase of the Socialists, labour would obtain its “full product” of consumable commodities (subtracting only whatever additional public capital had to be provided for the increase of its future produce).

Even Socialists, however, hardly venture to dream of any such increase in social production through governmental administration as we have above imagined. But it is important

to observe that any effective occupation by government of a portion of the present field of employment of private capital is a step towards the goal at which Socialists aim ; i.e. it tends to bring with it whatever advantages attach to the reduction of existing inequalities of distribution. And it is only such mild and gentle steps towards the realisation of the Socialistic ideal that I can regard as at all acceptable, in the present condition of our economic knowledge. I have made clear in the preceding chapter that I do not hold the proposal, that the community should prohibit interest and compulsorily purchase with terminable annuities the land and instruments of production now in private ownership, to be beyond the pale of theoretical discussion as immoral ; but I think that, considering the perils of so vast a revolution, we ought to have much more conclusive evidence than has yet been offered of the advantages to be derived from it after the struggle is over, before it can be regarded as at all ripe for practical discussion. At the same time, as I have tried to shew in an earlier part of this book, there are many departments in which both abstract theory and induction from experience combine to shew very serious defects in the existing competitive organisation of industry, from the point of view of production no less than from that of distribution. I see no reason to regard *laissez faire* as a political ideal from either point of view : and it seems to me quite possible that a very considerable extension of the industrial functions of government might be in every respect advantageous, without supposing any Utopian degree of moral or political improvement in human society. But at any rate to be successful such extension must, I think, be gradual ; and the first experiments in this direction ought to be made in departments in which the defects of private enterprise, and the advantages of unitary administration, have been shewn to be greatest—e.g. in departments where there is a manifest tendency to the establishment of monopolies in the hands either of single individuals or of associations. And, moreover, it ought to be an object in any such extension to maintain as far as possible in the governmental organisation of industry an adequate stimulus to individual enterprise, and adequate opportunities for private enterprise and initiative.

This leads me to a point which I may seem to have overlooked in my sketch of socialistic progress, whereas many writers have regarded it as the most fundamental objection to Socialism; the difficulty, namely, of distributing the produce of joint labour so as to apportion remuneration to desert. But in the preceding chapter I have tried to shew that we can only hope to realise a remote approximation to this ideal of distributive justice, by getting rid of all removable differences in remuneration that are due to causes other than the voluntary exertions of the labourers. And this result might, I conceive, be brought about through the assumption by government of the main industrial functions now performed by private capitalists, without any fundamental change in the principle of remuneration now adopted in respect of governmental officials, if at the same time the means of training for the higher kinds of work were effectually brought within the reach of all classes, by a well organised system of free education, liberally supported by exhibitions for the children of the poor. For as the instruments of production would be mainly the property of the nation, all the inequalities of income that now result from the payment of interest to private capitalists as such, or of profit to employing capitalists, would, speaking broadly, have ceased to exist; and though it would be impossible, without intolerable constraint on the freedom of action of individuals, to prevent the children of persons earning larger incomes or owning accumulated wealth from having a somewhat better start in life than the rest, still this advantage might be reduced to a minimum by such an educational system as I have suggested. Of course, under a completely Socialistic system, the governmental remuneration of superior qualities of labour could not be determined by any reference to the 'market price' of such labour, as there would be no market outside the service of government, by which its price could be fixed. It would therefore have to be determined economically by estimating the amount necessary to stimulate adequately to the acquisition of the required qualifications, and to compensate for any special outlay or sacrifices involved in such acquisition. But I do not see that this method of determination would present any great difficulties, if gradually introduced; especially since the influence

of competition need not be excluded altogether; there might be competition between one locality and another for the best *employés*,—or even between different departments of a central government.

The question would remain, whether the need of organizing new checks to population—which we have seen to be incident to Communism—would also arise under such a Socialistic system as I have just sketched. This question does not seem to me easy to answer decisively on the basis of our present experience. On the one hand, there is no positive necessity that any particular department of a Socialistic government should be bound to find work for any applicant: individuals might be left to find for themselves where their services were wanted, relief being provided for the unemployed under some such deterrent conditions as those of our existing poor-law. Still, in a community in which all, or the most important branches, of production were carried on by the government, there would be a general tendency among the unemployed to throw on the government the whole responsibility for their situation; and if their number became at any time considerable, a strong demand would arise, very difficult to resist, that the State should provide work and adequate wages for all applicants—should in fact establish the ‘Right to Labour’ which Socialistic agitators have at various times loudly claimed. It does not, however, appear to me clear that in a community successfully organized on a Socialistic basis, the Right to Labour would necessarily involve the evils which its establishment in any existing community would doubtless entail. If the government in such a country as England guaranteed even a minimum of necessaries to all who were able and willing to give a normal day’s work for them—without the deterrent conditions under which such relief is actually offered to able-bodied paupers in an English workhouse—we can hardly doubt that the labour thus purchased by the State could not, even by good organization, be made to pay the cost of its support. For a labourer employed under such a guarantee could not be dismissed for mere inertness or inefficiency, but only for such wilful and obstinate idleness as would justify his being sent to prison. Hence he would have much less motive than at present either for working energetically or for seeking

and qualifying himself for the employment in which he would be most useful; and his labour would tend to be proportionally less productive. At the same time the minimum of shelter and sustenance that humanity would allow to be given him would cost more than the earnings of the worst-paid labourers at the present time; and though the difference would be partly made up by the better work that would result from more adequate shelter and sustenance, we can hardly doubt that, on the whole, the measure would both materially diminish aggregate production and throw a serious burden on the public purse—both which effects would, under existing circumstances, tend continually to increase, as the security of employment would give an important stimulus to population. But if we suppose a community in which the aggregate remuneration of labour is increased by most of the share that now forms interest on individuals' capital, while the emoluments and dignities attached to the higher kinds of labour are brought within the hopes of all classes by a system of education which at the same time makes general such a degree of foresight and intelligence as is now possessed by the higher grade of artisans—I do not see why in such a community a minimum of wages should not be guaranteed to all who were unable to find employment for themselves, without drawing an ever increasing crowd of applicants to claim the guaranteed minimum, and without there being any great difficulty in the way of making the work of such as did apply self-supporting.

§ 5. Let us now return from imagining what may be in the distant future, to notice the general economic advantages and drawbacks of such measures for the mitigation of inequalities of distribution as can be considered to be now within the pale of practical discussion. The 'Right to Labour' to which we have referred in the preceding paragraph can hardly be placed in this category, merely in virtue of the transient and feeble experiment in this direction that was made in France in 1848; since no serious politician would now think of proposing that labour and adequate wages should be guaranteed by government for all applicants. And the same may be said of all proposals to raise the wages of the worst-paid labourers up to a certain minimum by allowances. All such schemes are

now generally seen to be open to objections similar in kind to those urged against the Right to Labour, and no less conclusive.

At the same time, in view of the distress which the worst-paid labourers in our modern communities endure, a vague demand continually arises for some kind of legislative remedy: and some persons appear still to think that government might reasonably *prescribe* a minimum of wages for all labourers able and willing to give a full day's work, without incurring the dangers connected with a governmental *provision* of such a minimum. But even supposing that such a regulation did not drive capital and enterprise abroad—as would probably be the case if it were introduced in one country only—we must expect it to decrease the demand for labour by increasing its cost¹ to the employer, not merely (as some have thought) temporarily but permanently. For, as we have seen², there is no economic law necessitating the employment of a certain *quantum* of labour along with a given amount of capital; on the contrary, the compulsory rise in its price would make it the employers' interest to adopt modes of employing capital which diminished the proportion of labour to capital. Hence, to prevent widespread distress, it would be almost necessary to supplement the *prescription* of a minimum of wages by the governmental *provision* of employment and remuneration; so that this method of raising wages could hardly fail to land us in all the difficulties of the Right to Labour.

The dangers of the measures just mentioned may be partly illustrated by the actual experience that has been gained of the dangers incident to a kind of governmental interference with distribution which all modern communities have thought necessary, in some form or other, for the protection of their members from absolute want of the necessaries of life. I have already pointed out that, according to the received view of Communism, which I have tried to express in a precise definition, the English

¹ The increase in the labourers' efficiency resulting from their higher wages might in some cases compensate for the increase in the price of their services, so that the cost of these to the employer would not be enhanced. But this effect could not be relied upon as a normal result of the regulation.

² Cf. *ante*, Book II. chap. viii. §. 2.

Poor Law must be allowed to be communistic in its effects—though it does not follow that its adoption is in any way due to a communistic design or principle. In fact if we look merely to the motive which prompts the community to grant all its members a legal right to relief, we should rather classify this measure with the interferences to protect life and health, which I noticed in a previous chapter. But if we protect the health of a starving person by giving him necessaries at the expense of the community, our action inevitably involves to some extent the evils of communism whatever its intention may have been: that is, it tends to decrease the inducements to labour, forethought and thrift in two ways, (1) by distributing to paupers a certain *quantum* of unearned commodities, and (2) by taking from non-paupers a corresponding portion of what they have earned or saved. The former of these bad effects may be in the main averted, so far as the inducement to labour for present needs is concerned, in the case of able-bodied paupers, by exacting work from them in return for relief under somewhat disagreeable conditions; for though it is probably impossible to keep this compulsory labour up to an average degree of energy, there being no fear of dismissal for slackness, still any attractiveness that might hence attach to the position of a pauper may be more than counterbalanced by restrictions on freedom, and by the prohibition of indulgences not necessary to health, but yet so cheap that even the poorest can occasionally enjoy them: and, in fact, English experience seems to show that the provision made for such able-bodied paupers as reside in a workhouse does not offer any serious temptation even to the worst-paid labourers to relax their energies in seeking employment elsewhere¹. On the other hand it seems impossible to prevent even 'indoor relief' from weakening the motives that prompt the poorest class of labourers to earn and save an adequate provision against sickness and old age, or for the support of their

¹ The vagrants, on the other hand, who spend single nights in the 'casual wards' of different workhouses, have a serious temptation to idleness in the shelter and food thus provided without adequate enforcement of labour in return. Efforts are now being made in England to reduce this evil, without losing the productional advantage which this provision gives by increasing the mobility of labour.

families in case of premature death: and this is still more manifestly the case with out-door relief. And it is the expense of supporting those who are wholly unable, or but very partially able, to work, which causes by far the greater part of the burden of taxation entailed by pauperism though, for the reasons already stated, the value even of the labour of the able-bodied falls seriously short of the cost of their shelter and sustenance.

The bad economic effects of this taxation on the persons taxed depend mainly on its compulsory character: since a man does not feel the reward of his labour to be lessened by the fact that he voluntarily bestows a portion of it in alms. It would seem, too, that if the destitute persons could be adequately protected from starvation by any measure that did not give them a definite legal right to relief, the discouragement to thrift which such legally secured relief entails would be partly avoided. Further, if the legal right to relief be kept inseparable from the deterrent conditions necessary to prevent its worst consequences, it cannot be regarded as a satisfactory provision for the case of deserving persons who have fallen into indigence either through inevitable and irremediable disaster, or at any rate from causes involving no serious blame to them. And in fact the most rigid supporters of the English poor-law have generally recognised the moral necessity of supplementing it by private almsgiving. On the other hand private almsgiving, being largely impulsive, unenlightened, and unorganised, is found to give serious encouragement to unthrift, and even to imposture. These considerations suggest, first, that Government might with advantage undertake the *organisation* of cleemosynary relief, in order to make its distribution as economical, effective, and judicious as possible; and, secondly, that the *provision* of funds for such relief—so far, at least, as they are used for the ordinary sustenance of adults in distress¹—might be left mainly to voluntary gifts and bequests, with a certain amount of assist-

¹ By this phrase I mean chiefly to exclude the sustenance of (1) destitute children, (2) the insane—whose support Government ought to undertake as a mere measure of protection to other members of the community, (3) persons incapacitated by special diseases. I also exclude medical aid generally, of which I afterwards speak.

ance from government, if experience shews it to be necessary, but without any legal right to relief. These two principles are maintained in the treatment of pauperism adopted in France, which is, I believe, generally approved by competent judges in that country; especially because the experience of France seems to shew that voluntary provision if carefully organised may be relied on as nearly adequate for the purpose of practically securing the poor from starvation: and also that where the applicants for relief have no legal right to it, the requisite alms may be distributed to them in their own homes without the demoralizing consequences that out-door relief has under our compulsory system: since the absence of legal security compensates for the absence of the deterrent conditions of the work-house.

But again: assuming that government ought to make a legally secured provision for any sick or infirm member of the community who may be destitute of necessaries, it does not therefore follow that the expense of this provision must ordinarily be undertaken¹ by the community, so far as adults are concerned; since it might be thrown, wholly or in part, on the individuals themselves by laying a special tax on their earnings for this purpose. Such a measure has been recently urged by Mr W. L. Blackley in a series of pamphlets. It must, I think, be conceded to Mr Blackley first, that though the *political*² interference with natural liberty involved in such a measure would be much more intense than that of our poor-law, the *economic* interference would be very much less, if the measure were completely successful; and, secondly, that the great majority of male and a considerable number of female, labourers in England might without painful sacrifices save enough to insure them against destitution in sickness or old age, before they attain the age of 21. Nor can I see that there are insuperable practical difficulties in the way of making such saving compulsory on all persons in regular employment: but it appears to be admitted that it could not be exacted from the class of persons who pick up their livelihood by various irregular kinds of work; and the

¹ That is, in default of near relatives on whom it may properly be thrown.

² For this distinction cf. *ante*, c. iii. (of this book) § 2, p. 427.

increase in the number of such irregulars that must be expected to result from the proposed measure seems to me a serious economic drawback. And further it does not seem that the measure could be applied to the worst-paid labourers—chiefly women—without reducing their wages below the amount required to keep them in health¹.

§ 6. Besides providing the necessaries of life to persons completely destitute, modern governments have intervened in various other ways, with the view of ameliorating the economic condition of the poorer classes at the expense, more or less, of the rest of the community. But such intervention, as I before observed, has usually aimed at improving production as well as distribution; and has, for the most part, been guarded in various ways against the bad consequences of communism. In some few cases it has involved no cost to the public exchequer; in other cases it has been concerned with the provision of commodities believed to be specially conducive to the moral or intellectual improvement of the classes benefited, and which at the same time hardly form an element of that 'standard of comfort' which supplies the chief ordinary motive to labour and thrift; in other cases it has aimed at making such a change in the circumstances of the persons assisted as would tend to strengthen on the whole, rather than weaken, habits of energetic industry, thrift, and self-help in the individuals assisted. Under the second head would come, for instance, the pecuniary aid, before discussed, which modern states have largely given to education—including the diffusion of culture by means of libraries, museums, &c.: under the third head I should place assistance to emigration, and also most interferences with the tenure of land, especially those of which the object has been to place the actual cultivators of the soil in a position more favourable to effective industry. As an example of this latter class we may notice the important assistance given in recent times by the Governments of Prussia and Hesse Darmstadt to facilitate

¹ Even in classes above the lowest in the scale of wages there would be many exceptional cases in which such a measure as Mr Blackley proposes would cause great hardship: as (e.g.) the case of young persons supporting widowed mothers, infant brothers and sisters, &c. But special methods of treatment suited to such cases might perhaps be devised.

the transition of their peasantry from feudal semi-servitude to the condition of independent proprietors. This assistance did not involve any direct pecuniary sacrifice on the part of the community; but it was nevertheless a distinctly distributional interference, since it gave the peasants the advantage of the superior credit enjoyed by the community—and also of the advantage in efficiency and cheapness which the governmental collection of rents was found to possess, compared with the collection by private individuals. From these two sources a margin was obtained enabling the cultivator to refund to the State, within a not very long period, the capital with which his landlord's rent-charge had been bought up, without any increase of his rent.

The intervention just described was for a special and temporary object. But experience has shewn that peasant cultivators are liable to become loaded with debt to money lenders who, either through the absence of effective competition—partly in consequence of a certain discredit that often attaches to their business—or perhaps sometimes through unavowed combination, are enabled to exact very onerous interest. This condition of debt tends to paralyse the productive energies as well as to cause distress: accordingly, under these circumstances governments may operate for the benefit of production no less than of distribution, by encouraging with special privileges the formation of commercial companies for the purpose of lending money on easier terms. Indeed, as was before said, the business of lending on the security of land seems to be of a kind that might even be undertaken by government itself under certain conditions, without the kind of risk that is involved in ordinary banking business. So too, where the pawnbroker is the normal resort in an emergency of poor labourers who have not saved or have exhausted their savings, governments, by undertaking the business of lending money at a moderate interest, may give sensible relief without offering any material encouragement to unthrift. Again, when the State subsidizes insurance-funds for the poorer classes, it is possible that the practice of thrift and forethought may be more importantly encouraged than the principle of self-help is infringed¹.

¹ It is noteworthy that in France, where the principle of the English poor-

Another important case of interference primarily distributional, but which also admits of being defended as beneficial to the community, is that of measures for protecting the wealth of the poor, so far as the cost of these is defrayed by taxation falling on the rich. Thus the provision of gratuitous medical advice and attendance both tends to benefit production by increasing the average physical vigour of the labourers, and also affords those who are taxed to pay for it a certain protection against infectious or epidemic diseases: and the same may be said of other sanitary measures primarily affecting the poorer classes, of which the cost has been, wholly or partly, borne by the community¹ on economic grounds.

How far the State *ought*, on economic grounds, to intervene in the matters above-mentioned, and others to which similar principles may be applied, is a question which involves a very difficult and complex comparison of various kinds of social utility. And I do not think that it admits of a precise general answer; as the balance of advantage in any case must depend very largely on particular circumstances and varying social conditions. One important consideration by which the answer must partly be determined is the extent to which provision has been made, or may be expected to be made, for the ends in view, either through the spontaneous association of the persons primarily concerned, or the philanthropic efforts of other individuals, or both combined. Thus experience has shewn that in important cases where mere competition among producers fails to lower sufficiently the price of certain commodities to the poorer consumers, the latter may successfully relieve themselves of the resulting disadvantages by spontaneous association—as in the case of the (artisans') 'cooperative stores' of England, and the 'cooperative banks' of Germany;—and where this remedy can be successfully applied

law is jealously excluded as communistic, the state—under a law passed 1868—has given subsidies proportionately large to funds for insuring workmen against accidents.

¹ An important example of such measures may be observed in the English Act of 1875 for destroying and replacing unhealthy blocks of houses in towns; since the total cost of this operation is necessarily much beyond what can be met by the rents of the new houses—due compensation being allowed to the owners of such houses as are not judged to deserve penal destruction, and to traders whose business connexion is impaired by dislodgement.

it is doubtless preferable, both for its direct and its indirect effects, to governmental intervention. Again, the promotion of education and culture, and the cure of diseases, have been largely provided for in modern civilised communities by the voluntary contributions of individuals; partly by the donations of the living, partly by bequests. Over the gifts (or loans) of the living the State can exercise but very slight control—except by offering to receive and administer them—without vexatious and dangerous interference with liberty; but the same danger does not attend interference with funds bequeathed for public objects: governments have always claimed the right of invalidating testamentary dispositions that are held to be contrary to public policy, and this principle might reasonably be applied to prevent bequests of which the economic consequences are clearly seen to be disadvantageous. Further, as the administration of such funds is generally removed from the influence of the ordinary economic motives prompting to the most useful employment of wealth, it is important that it should be carefully supervised by the State, in order to carry out the real wishes of the testators; and also that the schemes of the latter should be subject to thorough revision when a certain period has elapsed; since human foresight is very limited, and the fitness of any detailed regulations—even if originally well-contrived—for effecting any purpose of social utility, is pretty sure to decrease as time goes on. Interference of this latter kind, however, should be controlled by a careful regard for the testators' main aims and wishes, for fear of seriously checking the disposition to make such bequests: since it is an important gain to society that such expenditure as is desirable for the purpose of ameliorating the condition of the poor should be defrayed by this means of supply so far as possible, rather than by taxation. On this ground it may even be desirable that government should to some extent encourage such bequests, where the disposition of the funds bequeathed is approved as on the whole socially useful, even though the purpose served be not one for which government would otherwise have thought it needful to provide; by relaxing as far as may be any rules of law that operate to their discouragement, bearing the cost of their supervision and revision, and perhaps partially exempting the property bequeathed

from taxation. Of the propriety, however, of this latter measure we shall be in a better position for judging when we have discussed the principles on which a system of taxation should be constructed.

Finally, we must notice a special mode of governmental action tending to benefit the poorer classes, which cannot appropriately be classified as an 'interference' either for production or for distribution: viz. the management of any branch of industry carried on by Government so as to increase the supply of the commodities furnished by it at a certain sacrifice of the profit made by the business. One example of this is the provision of cheap conveyance by railway for working men: and, as this example suggests, the measure may be carried into effect not merely in businesses under governmental management, but also in those managed by private companies which have been compelled to submit to a certain amount of governmental regulation in return for special privileges conferred upon them. The question, however, to what extent it is expedient for Government to make this sacrifice of profit—or to enforce it as a part of the bargain made by the State with private companies—can hardly be separated from a consideration of the ways and means of obtaining funds for governmental expenditure generally: to which we shall proceed in the next chapter.

CHAPTER VIII.

PUBLIC FINANCE.

§ 1. I HAVE deferred to this chapter the discussion of the subject which, in the view of Adam Smith and many of his successors, is the main and almost the sole concern of the Art of Political Economy; viz. the "provision for the expenses of the Sovereign or the Commonwealth:" or, as it seems convenient to call it, Public Finance. I have adopted this course, because it seemed clear that the general discussion of the principles of governmental interference, either for the improvement of production or of distribution, ought, if introduced at all, to precede the discussion of the principles of Finance: since most known methods of providing for the expenses of the Commonwealth involve important effects both on production and on distribution, and our judgment as to the expediency or legitimacy of these effects cannot fail to be influenced by the conclusions adopted on the questions discussed in the preceding chapters of this book. It is true that considerations of this kind cannot always be decisive: the hard necessity of obtaining supplies for the exigencies of Government may compel a financier to adopt measures whose detrimental effects on industry are generally recognised; but none the less is it desirable that he should take account of these effects, in order that, if he is unable to avoid them altogether, he may mitigate or compensate them as far as possible.

Some writers, again, have taken a somewhat narrower view of the subject of the present chapter: confining their attention to what they have designated as the "theory of taxation." And no doubt, in any modern civilised community, taxation is the

chief mode by which the ordinary pecuniary wants of Government are supplied. But in no community is it the sole mode; and it appears to me that we are likely to get a clearer view of the principles on which a system of taxation ought to be constructed, if we begin by considering other methods of attaining the financier's end. Indeed my doubt is rather whether the scope of this part of our discussion should not be enlarged still further, so as to include the economic principles of governmental expenditure as well as the provision for defraying such expenditure. It is, however, difficult in treating of the art of economically organising governmental administration, to get beyond the general principle that we ought to aim at producing the greatest possible result with the least possible cost, without entering into the details of governmental business to an extent which seems unsuitable to the character of this treatise. I do not therefore propose to treat of the art of public expenditure, except so far as it is specially connected with the art of providing for such expenditure.

There are two ways in which this connexion becomes important. In the first place, we have to make the general observation that we cannot properly take governmental expenditure as something of which the amount is fixed prior to the consideration of the methods of supplying it and their effects. Practically, no doubt, the problem of finance is often presented to a statesman in this simplified form: but theoretically we must regard both expenditure and supply as having at least a margin within which the restriction or enlargement of either must partly depend on the effects of the corresponding restriction or enlargement of the other; within which, therefore, the gain secured to the public by an additional increment of expenditure has to be carefully weighed against the sacrifices inevitably entailed by the exaction of an additional increment of supply. This remains true even if the sphere of Government be restricted to the 'individualistic minimum' given at the outset of chap. iii. No doubt it is the worst possible economy not to make adequate provision for the necessary and acknowledged functions of Government; but adequacy in such cases cannot be defined by a sharp line. Most Englishmen are persuaded that they at present enjoy very tolerable protection of

person and property against enemies within and without the country; but it would be difficult to argue that our security would not be enhanced by more and better-paid judges and policemen, or more and better-equipped soldiers and sailors. Proposals, in fact, are continually made for increased expenditure in one or other of these directions: and it is obvious that in judging of such proposals a statesman must balance—roughly no doubt, but as well as he can—the advantages of increased governmental efficiency against the difficulties and drawbacks of obtaining increased supply. And it is still more evident that any question as to the extension of what Mill distinguishes as the “optional” functions of Government must be decided by a similar balance of considerations.

But again, the theory of expenditure has another special connexion with the theory of supply, so far as particular sources of supply are specially adapted to particular kinds of expenditure.

§ 2. In order to show the importance of this latter connexion let us consider separately each of the chief modes by which Government obtains the commodities it requires. These commodities may be divided into (1) Services, (2) Material products requiring to be continually supplied, and (3) Land, buildings and other comparatively permanent investments of capital; and both services and material products may be obtained either (*a*) without purchase, or (*b*) by purchase with money previously provided in some way. In many civilised countries an important part of the services required by Government is obtained otherwise than by free exchange. In England, for instance, the work of legislation is unpaid; and so is a considerable share of the judicial work, whether performed voluntarily, as in the case of magistrates, or compulsorily, as it is by jurymen. We are not, however, concerned to do more than notice these facts: since the desirability of imposing or accepting these unremunerated services is, I conceive, a political question in the decision of which economic considerations have but a subordinate place. This cannot be so decidedly said in the case, economically far more important, of labour obtained compulsorily for the purposes of military (including naval) service. The defenders of the compulsory system have no doubt urged other than economic rea-

sons in its favour—it has been said that the defence of one's country is a function which ought to be undertaken from patriotism or a sense of duty, rather than from mercenary motives and a taste for the incidents of the painful business of mutual slaughter; it ought therefore not to be made the work of a special profession recruited in the ordinary way by free contract; but rather imposed upon all citizens, whom there is not some special reason for exempting. It has been urged further that this system diminishes the constitutional dangers inseparable from the existence of a large standing army; since conscripts are less likely than professional soldiers to be seduced into fighting unjustifiably against the established political order.

But, whatever weight may be attached to these or other non-economic arguments, it seems undeniable, at any rate, that under certain circumstances there may be overwhelming economic considerations in favour of compulsory service. Where, indeed, the number of soldiers and sailors required for warlike purposes is not large in proportion to the population, and their services can be obtained at about the rate at which labour of similar quality would be hired for peaceful industry, voluntary enlistment seems clearly the most economical system; since it tends to select the persons most likely to be efficient soldiers and those to whom military functions are least distasteful; both which advantages are lost by the adoption of the compulsory system. But a nation may unfortunately require an army so large that its ranks could not be kept full by voluntary enlistment except at a rate of remuneration much above that which would be paid in other industries for labour that requires no more outlay in training and no scarcer qualifications: and in this case the burden of the taxation requisite to provide for such an army may easily be less endurable than the burden of compulsory service.

However to present even the economical argument on this question completely we should have to consider the respective advantages of short and long service, the proper relation between the regular army and the reserve, and other details of military (and naval) organisation into which my limits do not allow me to enter.

It may be observed that even where the services of soldiers

and sailors are obtained by a compulsory system, their pay and equipment are chiefly provided at the expense of the nation; though it has generally been thought expedient to reduce this cost by allowing the wealthier members of the community to serve for a shorter period of time at their own expense.

The material products required by the state it seems ordinarily expedient to obtain by purchase, leaving it to private industry to provide them; for the reasons that lead us to recognise the general economic superiority of the present individualistic organisation of industry. But in certain cases these arguments either do not apply or are out-weighed by special reasons in favour of State manufacture: either where the articles required by Government are of a quite peculiar kind (such as the instruments of warfare, cannons, ironclads, &c.) so that the advantage of free competition is not likely to be obtainable at all, or is more likely to be obtained if Government undertakes the manufacture; or where the quality of the article is very important and at the same time difficult to test if obtained by purchase; or where systematic and costly experiments in production are required.

In the case however of land, buildings, and other comparatively permanent kinds of wealth what has practically to be considered is often not how the state is to be supplied with it, but rather how far it is desirable that it should retain possession of it. Much of the land that now belongs to the public in the form of roads, commons, forests, harbours, &c, has never been private property: other portions of it, in modern European communities, have been the semi-private property of the royal families in feudal and semifeudal times, and have since gradually acquired, more or less completely, the character of public property; other portions have been taken from individuals or societies in the way of confiscation. But however such property may have been obtained, there can hardly be any valid reason for keeping it now unless it is required for the due performance of necessary governmental functions or likely to be more useful socially under governmental management. So far as neither appears to be the case, it is obviously an economic gain to sell it and employ the proceeds as capital in some department of properly governmental business.

§ 3. The greater part, however, of the material provision for the needs of Government has to be obtained annually or from time to time by purchase: and we have now to consider the different sources of the funds for defraying such purchases and also paying the wages and salaries of the paid servants of Government.

The chief sources are

- (1) Rent or Interest paid by individuals for the use of wealth that wholly or partially belongs to the community.
- (2) Loans.
- (3) Payments for commodities supplied by Government.
- (4) Taxes (including tributes paid by foreigners).

Such minor sources as Fines and Voluntary Gifts are too insignificant—so far, at least, as the main functions of Government are concerned—to require more than a passing notice¹.

Under the first of the four heads above given will come, of course, all rents paid for land or buildings that are completely public property. But besides these, wherever land has only been allowed to pass into private ownership under the condition of a periodical payment being made to the government,—or of services being rendered which have afterwards been commuted for a pecuniary payment—this payment should always be regarded, *from the point of view of distribution*, as a rent reserved by the community and not as a tax on the owner of the land; since in taking it the State does not take from the landowner wealth that has ever belonged to him, or to which he has any rightful claim. But though this is the true *distributional* view of the payment, it must be borne in mind that if it be proportioned to the value or rent of the land, it is liable to have the *productional* bad effects of a tax in the way of checking agricultural improvement. On the other hand a payment of this kind that is guarded from such effects seems to be a most unobjectionable mode of raising funds for public expenditure.

Interest of any other wealth besides land has hardly a place among the sources of income of modern governments, though it figures importantly among the outgoings. If they lend, it is

¹ Except in the case—of which we shall presently speak—where what is formally a tax may be fairly considered to be in substance partly a fine.

usually borrowed money; but their borrowings have been vast. In many cases such borrowing is economically quite justifiable; but the limits of prudent indebtedness have been found practically difficult to observe.

We may say generally that the conditions under which it is prudent for a nation to borrow are, to a great extent, analogous to those under which it is prudent for a private person to do so; but there are certain important differences. In the first place, a nation can borrow without incurring any but a very trifling burden, to whatever extent its obligations can be kept permanently current, as a national medium of exchange. And secondly in the case of the nation, the matter is complicated by the difference between what we may call the strictly financial and the social points of view: i.e. between the estimates of gain and loss to the national exchequer, and the estimates of gain and loss to the community considered as an aggregate of individuals. There are two chief cases in which private borrowing is recognised as legitimate: first, where the loan is employed productively, so that the additional profit obtained by the use of it supplies a fund from which the interest may be paid, and a certain portion of the principal annually repaid; and secondly where it is employed to meet an occasional necessity for enlarged consumption, which could not be defrayed without inconvenience or even suffering out of the income of a single year, so that it is good economy to spread it over several years. Each of these cases has its counterpart in public finance. Here, however, it is not always easy to decide whether a loan has been employed productively for the nation at large. For the returns on productive outlay by government may take two quite different forms; they may either appear as increased profits on some special business carried on by a governmental department, in which the loan has been employed as capital—as when (e.g.) telegraphs or railways are bought for the State with borrowed money; or they may merely be realised in the increased produce obtained by the labour and capital of the community governed—as when a Swiss canton borrows to make a road without tolls for the use of travellers, for which it is repaid by the increased earnings of its innkeepers or tradesmen. This latter kind of outlay, however, even when socially profitable, cannot be

regarded as productive from a strictly financial point of view, unless the Government secures a share of the increase of national produce, sufficient to pay something more than the interest on the loan. And it may obviously be sometimes very difficult to say how far any particular increase, either in national produce or in governmental receipts, is really due to the supposed productive outlay and not to other causes of national prosperity. Borrowing for this latter kind of expenditure therefore, though often highly advantageous, requires to be very carefully watched; especially if—as has too often happened—the borrowing government has some sinister interest in the expenditure.

Still, on the whole, the general principle for determining productive outlay is clear, however difficult its application may be in some instances; the increased receipts accruing to the community in consequence of the outlay—whether they are obtained by the community in its corporate capacity or as an aggregate of individuals—ought to be more than sufficient to repay the loan with interest by the close of the period required to exhaust the productive effects of the outlay¹. It should be added that when such borrowing involves loss from a strictly financial point of view, we have to take into account—as against any advantages that may be expected from it to the community at large—all the disadvantages attaching to the part of the system of taxation that might be dispensed with, if the debt were not contracted.

I pass to consider the second case of legitimate borrowing; where the loan is required to meet an occasional need of extra expenditure, not positively productive. In this case the rule to be adopted appears *prima facie* very simple; it would seem that the number of years over which the sacrifice imposed by the emergency may prudently be extended ought to be limited by the condition of paying off the loan before a similar emergency may be expected to occur again. Practically, no doubt, the exact application of this principle in national finance is a matter of extreme difficulty; since the chief emergencies which

¹ In some cases no doubt fixed capital may be actually permanent; but in consideration of the frequent changes in industry it can never be prudent to reckon it as such.

necessitate such loans are foreign wars (or menaces of wars) and there are no known sociological laws by which we could forecast the magnitude and frequency of a nation's future wars, in the present stage of civilisation. Still, if we simply infer the probability of future wars from past experience, it must be admitted that the above-mentioned principle has been flagrantly transgressed by most of the leading nations of modern Europe. But the alarm which such transgression might reasonably arouse may be to some extent diminished by the consideration that we may equally infer from past experience a probable reduction in the burden of any national debt already contracted—both an absolute reduction, from the decline of the rate of interest, and a relative reduction from the increase of the aggregate wealth of the borrowing nation. At the same time, there is so much uncertainty in all inferences of this kind that I can hardly consider a community to be justified in deliberately disregarding the rule of repayment above laid down; except, perhaps, when the taxation that would be required in order to conform to this rule would entail very serious economic or political inconveniences¹.

We have already seen that from a social point of view borrowing may be profitable, by increasing the aggregate produce of the community, even though it does not bring in an adequate return to Government, either in the form of profits on a special business in which the loan is employed, or more indirectly by an increase in the yield of certain taxes. In such a case, however, it is most probable that the increase in the total income of the community will not be equally distributed among the incomes of individual members; hence, unless the

¹ I have not space to discuss adequately different modes of national borrowing; but I may briefly note the wastefulness of borrowing in such a way that the amount received is less than the debt incurred; since this method renders the borrowing nation unable to take advantage of any subsequent fall in the rate of interest, except at a serious loss. It may be said that it gives a corresponding security to the lenders, so that what the nation loses in one way will be compensated by its obtaining the loan on otherwise more favourable terms: but the security to the lenders is an indefinite and (if I may be allowed the phrase) insecure one, and therefore likely to be undervalued. If a security of this kind is to be given at all, it is more economical for the nation to guarantee its creditors against repayment for a certain period,—or for a period varying within definite limits, the variations being determined by lot.

interest and repayment of the loan can be provided by imposing a rate on the persons who gain by its employment, fairly proportioned to their respective gains, it has a tendency to cause a new inequality in the distribution of wealth which ought to be considered in adjusting the general burden of taxation.

There is another less obvious disturbance of preexisting distribution which borrowing, whether for profitable outlay or to ward off calamities, tends to bring; viz. by raising the rate of interest, and thereby increasing the share of the aggregate produce that falls to capital. Where the outlay is of the profitable kind it is not necessary that this increase should be accompanied by a diminution in the reward of labour; as it is possible that it may be entirely supplied from the increase in the aggregate produce. But in the case of loans for wars or similar purposes, the gain to capitalists from the rise of interest inevitably involves a corresponding loss to labour, supposing that the capital is supplied by the members of the borrowing community, and that it would in any case have been saved and invested in some branch of home industry. These suppositions, however, can rarely altogether correspond to the facts; and so far as the capital borrowed is obtained from abroad, or would otherwise have been sent abroad for investment, it is quite possible that the immediate effect of the borrowing may be pecuniarily advantageous both to capitalists and labourers; the aggregate of produce distributed within the community being temporarily increased by the loan. Thus the first years of war may be felt as years of prosperity by all classes. The day of reckoning must of course come for this expenditure; and the account must ultimately be paid in part from the share of labour,—unless indeed the interest on the war-loan is supplied by taxes falling entirely on capitalists.

§ 4. In considering the different occasions for governmental borrowing, we have incidentally noticed that, while the major part of the ordinary income of governments is derived from taxes, a certain portion is actually in most civilized countries obtained from payments for the products of governmental industry, purchased freely by the individuals who need them, just as the commodities provided by private industry are purchased. It will be convenient to distinguish these payments

as "earnings" of Government. Such "earnings" may be classed under two heads, for the purposes of the present discussion. In some cases they are obtained by selling products or services at their market-value, determined by the competition of private industries, as (c.g.) where a government possesses domain-lands and sells the agricultural products obtained by cultivating them, or similarly sells wood out of its forests, &c.¹ In other cases a government has established for itself a monopoly of certain branches of industry, either to secure the full economic gain obtainable by organising the industry under a single management, or for the better prevention of fraud, or—as will be presently explained—with a view to taxation. In Great Britain the only business thus monopolized, besides coinage, is that of conveying letters and telegrams; in other countries various other industries are similarly conducted, as (c.g.) certain kinds of mining, the manufacture and sale of tobacco, opium, even lottery-tickets.

The financial problem is obviously very different in the cases of the first and second class respectively. When the price of the commodity supplied by the government is determined by open competition with private industries, the only question is whether the government ought to carry on the business at all; whether it would not be more economically managed if handed over to private capitalists. Under ordinary circumstances, this question may be decided by a mere calculation of the financial profit of the governmental business: but, as we have seen, there are cases where it may be desirable that Government should carry on a certain branch of industry under unremunerative conditions, for the sake of some general utility which the competitive system cannot be trusted to provide.

Where, on the other hand, the industry is protected by a monopoly, there is more difficulty in determining what shall be the amount and price of the commodities supplied. A private monopolist may be assumed to aim at the greatest net gain to himself: and a governmental monopoly ought clearly to

¹ We may also include under this head the case of industries undertaken by Government for the sole purpose of supplying government itself with certain products: where, therefore, there are no "earnings" in the ordinary sense of the term.

be managed on the same principle, so far as it is considered strictly from a financial point of view, as a means of obtaining money for governmental purposes. And though this ought never to be the sole consideration for a government—since it has to regard the interests of those of its subjects who buy the monopolized commodity, and any others who are indirectly affected by its use—still there are cases in which the financial view may reasonably be allowed to prevail; as for instance where the commodity monopolized is a dangerous luxury. Even in other cases it may be on the whole expedient to keep the price of the monopolized commodity above the point that it would otherwise reach, for the sake of the profit to the treasury. But when this is done, it is clear that the purchasers of the commodity are substantially taxed for the benefit of their fellow-citizens: in fact the establishment of a monopoly is a recognised mode of raising a tax on an article of consumption, which has important advantages in some cases, especially in diminishing the cost and trouble of preventing evasions of the tax. On the other hand if the price be reduced below a certain point, a special bounty is conferred on the purchasers at the expense of the rest of the community. It is not, however, quite clear at what point Government ought to fix the price, if it would avoid all interference with distribution, by neither taxing nor benefiting the purchasers.

There are two views that may plausibly be taken.

(1) It is thought by some that Government avoids taxing one part of the community for the benefit of the other, if it sells the commodity at the lowest price which allows interest on the capital employed, at the rate at which Government could borrow it, after paying all the current expenses of production, including the remuneration of all the officials employed and allowance for depreciation of capital. For—it is said—if the national exchequer gains by the business, the extra price that provides the gain is substantially a tax on those who purchase the commodity for the benefit of the rest of the community: while if it loses the community is taxed for the benefit of these particular purchasers. There ought therefore to be neither gain or loss.

But (2) I should rather hold that Government avoids interfering with distribution, if it sells the commodity at the price

at which it would be sold if provided by private industry. This price, however, may very possibly be higher than that at which Government could supply it without gain or loss; since the article may be one which either would be less economically supplied under the conditions of free competition, on one or other of the grounds explained in Chap. ii. of this book, or would be practically monopolised. In this case I should urge that the advantage which the community gains through the business being undertaken by Government is one to which the particular purchasers of the article have no claim; and that therefore if the price of the article is reduced, in the interest of production, the reduction ought to be regarded as a special benefit to them, for which allowance ought to be made in the adjustment of the whole system of taxation¹.

Sometimes, no doubt, it may be the real interest of the community, considered as an aggregate of individuals, that such a reduction should be made; and even that it should be carried so far as to prevent the monopoly from yielding ordinary interest on the capital employed. Indeed if this capital were not borrowed, and if we had not to consider the need of raising supplies for other branches of governmental expenditure, there would seem to be no reason why the condition of paying interest should be regarded at all, any more than it would be regarded in a community socialistically organized; it would be economically advantageous to extend the supply of the commodity by cheapening its price so long as it more than repaid the total cost of the labour spent in furnishing it—including the labour required for keeping in repair and duly improving the instruments used in the business. But since actually any portion of national income sacrificed in this way,—by a reduction of price below what would have to be paid apart from governmental interference—must be made up by some other tax, it will only be desirable to make such a reduction under special circumstances; as (e.g.) when the increase of supply would be very considerable in proportion to the diminution of net profit, or where such increase

¹ It must be admitted that the criterion which I regard as the true one cannot easily be made exact; since under ordinary circumstances we can only conjecture roughly the price at which any commodity would be supplied by private industry.

is likely to be importantly beneficial to the community generally.

§ 5. We have just seen that the line between "earnings of Government" and "taxes" is not altogether easy to draw, in the particular case of monopolized articles. We have now to observe that the general distinction between these two terms is not quite so clear as it appears at first sight. No one, I suppose, would apply the term "taxes" to payments for goods or services furnished by Government which the payer is left perfectly free to take or to leave—except so far as the price of the service is raised in the way just discussed—; even where, if the commodities are purchased at all, they must be purchased from the government, as in the case of payments for postal services. But, if so, it seems doubtful whether a payment of this kind acquires the character of a tax merely because it is made compulsory; as, for instance, where landowners are compelled to take a share in the cost of works of drainage or irrigation carried on by Government. On the other hand some economists hold that all taxes—i.e. all compulsory contributions of individuals to their Government—ought to be regarded as payments for services received; and that the burden of taxation ought to be distributed on the principle which is obviously equitable in the case of such payments: viz. that every individual should pay an equivalent of the cost¹ of the services rendered to him. And I quite admit that this is the most consistent way of treating the problem of taxation from an individualistic point of view, so far as the services rendered by Government admit of being thus individualised. But when I try to apply this principle in the case of the most important—and actually most costly—functions of government, I find it to a great extent impossible to determine with even approximate exactness the amount of services rendered to any particular individual. The difficulty is greatest in the case of defence against foreign foes; since modern wars are undertaken not mainly for protection of life and property of individuals, but for the maintenance of national existence, extension of empire, &c.; and it is impossible to apportion the

¹ It should be observed that where different kinds and qualities of services are performed by the same organisation, the share of each corresponding to any particular services can often be only roughly estimated.

advantages thus purchased among the individual members of the community. So again, how are we decide who profits by the sumptuous expenditure of the monarch and the royal family in a monarchical country? It is plausible to maintain with Bagehot that this "ceremonial" part of government is kept up to give a "human interest" to the dull business of governing, and thus win the sympathies of comparatively uneducated persons for the established political order, and call out their emotions of loyalty. On this view the benefits of the expenditure accrue partly to these uneducated persons themselves; partly to persons who would otherwise have reason to fear their disaffection. On the other hand there is something to be said for Mr Sargant's view that it is the people who go to Court that especially benefit by the expenditure of the Court, and may therefore fairly bear a special tax in order to defray it. And, on the whole, without affirming that all members of the nation are equally concerned in maintaining either its international position, or its monarchical constitution, I cannot but regard as hopeless the attempt to apportion the cost of either among different classes on what I may call the 'fee-principle'—that is, the principle of payment in proportion to services rendered. I hold, therefore, that at any rate for the taxation required to defray the expenses of the Court, the army and navy and diplomatic service, and the interest on national debts incurred for warlike purposes, some other principle of distribution must be sought.

It may seem more plausible to apply the fee-principle to the support of the administration of justice and the police; since both judges and policemen are continually engaged in rendering special services to certain individuals. On the other hand it is contended, by Bentham and Mill¹, "that those who are "under the necessity of going to law are those who benefit least, "not most, by the law and its administration:" and so far as the necessity is in no way brought on them by their own fault, this seems undeniable. It may be expedient, indeed, to check litigation, that the cost of administering justice should fall largely on individuals; as is actually the case so far as the services of solicitors and barristers are paid by the litigants. But it is at any rate desirable that as little as possible of this

¹ Mill, c. v. § 3.

expense should fall on innocent individuals—innocent, that is, not only of violation of rights but even of undue litigiousness. It seems clear, therefore, that the support of the Judicature and police cannot, at least in the main, be defrayed by fees from the persons whom judges and policemen are more obviously occupied in protecting. At the same time, I do not think that the principle of apportioning the tax-payer's contribution to the services which he receives so completely inapplicable here, as it is in the case of taxes for national defence: and we are almost compelled to have recourse to it to a certain extent when we come to deal with the question of determining the area of incidence of taxation.

The ordinary answer to the question, "who ought to pay taxes to a government" is Adam Smith's,—“the subjects of “the State” governed: but when the same question is raised in reference to a local tax, the ordinary answer is “the persons “residing or possessing property in the district;” and a comparison of the two answers shews us the necessity of qualifying the first. It seems clearly just that aliens residing or possessing property in any country should pay something towards the expenses of its government; and if so, unless aliens are to be fined as such, it is clearly just that they should pay proportionally less to their own government; and the only satisfactory way of determining the ratio in which their contribution ought to be divided between the two governments is by regarding it as a price paid for services received. An Englishman residing in France is much less concerned than a Frenchman with French expenditure on armaments; but he has as much interest as a Frenchman has in the expenditure for maintaining internal order and promoting wellbeing in France; and he is also benefited by this latter outlay if without residing in France he merely holds property there. It seems therefore just that at least a rough division should be made of the taxes ordinarily paid by an Englishman into three parts; one part to be paid by him to the English government wherever he may reside or hold property; another to the government of the country in which he resides; while the third should be proportioned to the property that he enjoys under the protection of his own, or any other, state.

The same principle, again, may be applied—and actually has been applied to a considerable extent—in determining the division between general and local taxation within any country. Where expenditure defrayed by taxes benefits the inhabitants in a certain locality almost exclusively, and other persons only so far as they resort to the place—thereby usually benefiting its trade—it seems in accordance with natural justice, individualistically interpreted, that the taxes should be correspondingly localised; as, for instance, in the case of expenditure on streets, and bridges so far as they are not maintained by tolls. Where on the other hand a more considerable share of the utilities produced tends to be diffused through the community, though residents in a certain locality benefit more than others, a division of the cost between local and general taxation is on similar principles equitable: thus (e.g.) it is reasonable that the pecuniary aid given by Government to elementary education should be furnished partly from national, partly from local, resources, so far as it is given on strictly individualistic principles—that is with the view of benefiting persons other than the children educated. A similar division of cost would seem to be also equitable in the case of Poor-relief; but here considerations of justice appear to be overborne in England by the special need and difficulty of maintaining a very strict economy in poor-law administration.

To sum up: I do not think that any sharp line can be drawn between taxes, ordinarily so called, and any compulsory payments for services received from Government; and I accept generally the principle of fixing the individual's contribution to Government so as to be as nearly as may be equivalent to the cost of the services performed by Government to him, so far as such services can be properly regarded as rendered to individuals. At the same time I think that this principle can rarely be applied, except in a rough and partial way, to any payments that are ordinarily called taxes; and that even where it is most applicable, it must often be overborne by other considerations—sometimes by the economic advantage of more uniform rates of payment, sometimes by the desirability of reducing the burden laid on the poorer class of contributors. Nor does it seem that there is necessarily any sacrifice of

justice, even from an individualistic point of view, in throwing a part of the cost of services which men are compelled to purchase on persons other than the recipient; since from this point of view the only admissible reason for compelling any individual to purchase such services is that the interests of others will be damaged if he is allowed to dispense with them; hence it seems not unfair that these others should bear a part of their cost. And, finally, there is a large part of governmental expenditure—much the largest part in our European nations, loaded with war-debts, and armed to the teeth—the utility of which cannot be thus distributed among individuals. Let us proceed then to consider the method by which Government ought to raise the contributions required for such public expenditure as cannot reasonably or conveniently be provided for by charging individuals in proportion to services rendered; where there is no public income adequate to such needs derived from land or other wealth owned by the community or from the profits of governmental business. It will be convenient to call this the method of ‘taxation’ in the strictest sense.

§ 6. I ought, however, to premise that in the discussion which follows I do not propose to deal with the problem of constructing a system of taxation, as it presents itself practically to a statesman. It does not seem to me that this problem can be satisfactorily treated in a work on general economic theory; especially because, as I shall shew, the considerations that ought to influence a statesman in choosing, rejecting or adjusting particular taxes are very various and complicated; and though we may usefully explain and classify them in a general theoretical discussion, we cannot pretend to estimate precisely their relative importance without careful ascertainment of the particular social and industrial conditions of the community to be taxed. Indeed there are very important political reasons for preferring some taxes to others, and for seeking to realize certain ends in taxation generally, which lie beyond the scope of a strictly economic discussion. Thus the third of Adam Smith’s famous canons—that “the tax which each individual is bound to pay” ought to be “clear and plain to the contributor” in respect of time, manner and quantity—is a constitutional rather than an economic principle:

its primary object being, as Adam Smith explains, to protect ordinary citizens against illegitimate exactions and extortions on the part of officials. So again, in a community where representative institutions are fully developed, there is an important constitutional ground for maintaining equal diffusion of the burden of taxation; viz. that the citizens generally may be equally interested in checking superfluous governmental expenditure, which special classes of persons are continually prompted by strong selfish motives to extend. Indeed the force of this consideration has led some thinkers to hold seriously that the burden of taxation ought to be as much as possible *felt* by those who bear it, in order that they may have the strongest possible motives for minimizing it; and perhaps in a very orderly and law-abiding and lightly-taxed community this might be desirable: but in most actual societies the dangers arising from "ignorant impatience" of taxation are so much graver than any which "ignorant patience" could cause, that it should rather be a maxim of statesmanship to avoid if possible any species of tax that is particularly disliked by the persons on whom it falls, even if the dislike seems groundless and fanciful¹. Further, it hardly seems within my province to deal with the very important political question, how far a statesman in constructing a scheme of taxation ought to take a cosmopolitan point of view; and not try to throw the burden of a tax on foreigners, except so far as it is fair compensation for services rendered to them, nor, in estimating injurious effects on production, consider detriment to foreign industries as indifferent—or even advantageous, if they rival industries of his own country. In a previous chapter (ch. v.), however, we have had occasion to examine the manner in which a 'tribute' may, under certain circumstances, be obtained from foreigners by means of import duties; and I shall refer to the subject again in a subsequent section: but for the most part I shall assume, for simplicity, that the burden of a tax is borne by the nation whose government imposes it.

In considering more particularly the mode of imposition of

¹ It should be noted that there are also strictly economic grounds for this maxim, so far as dislike of a tax causes it to be *evaded*, legitimately or otherwise.

this burden, it will be desirable to keep in view our fundamental distinction between effects on Production, or on the aggregate wealth of the community, and effects on Distribution, or the incidence of the burden of taxation; though, as we shall see, it is impossible to separate the consideration of the one kind of effects from that of the other. Under the former head, the financier is chiefly concerned with effects which he would desire to avoid as far as possible¹; namely the different extra costs of different taxes—the burden they impose on the taxpayers, over and above the net gain that they bring in to the treasury. In estimating these we have to distinguish the strictly financial cost—the expense of collection—and what may be called the extra-financial cost, i.e. chiefly the loss entailed on the consumers by changes in products or modes of production caused by taxes. The discussion of the former kind of cost, and of the best methods of minimizing it, belongs to the technical side of financial administration, and I shall not enter upon it further than to notice one or two considerations, so fundamentally important in constructing a system of taxation that they can hardly be omitted: what I shall chiefly consider, under the head of “effects on production” are the—generally detrimental—changes in the extra-governmental organisation of industry which the financial interference of government entails.

It is, however, with the problem of distribution that we are primarily concerned, when treating of taxation in the most general way. Effects on production are properly regarded in relation to particular taxes taken by themselves; since a tax that, from the point of view of production, is bad when contemplated by itself, remains no less bad when contemplated as part of a complex system of taxation; it may be eligible as the least bad among possible alternatives, but its badness cannot be neutralized by combining it with other taxes. But the case is otherwise with effects on distribution; for when a tax is defective on account of the unequal distribution of its burden, the defect can be at least roughly compensated by the imposition of some other tax with an opposite kind of inequality—and, as we shall see, such

¹ In some cases, however, we may take into account the indirect gain that results from the restriction of the consumption of harmful luxuries.

rough compensation is all that the financier can practically aim at. Hence, in considering taxation in the aggregate, the question of distribution is the primary one.

§ 7. What then are we to lay down as the fundamental principle for the distribution of the burden of taxation in the narrower sense—that is, of the burden that remains to be allotted, when the principle of payment in proportion to services received has been applied as far as is reasonable? The obviously equitable principle—assuming that the existing distribution of wealth is accepted as just or not unjust—is that equal sacrifices should be imposed on all; and this also obviously the most economic adjustment of the burden, except so far as it is thought desirable to make taxation a means of redressing the inequalities of income that would exist apart from governmental interference. The introduction, however, of this latter principle to any marked extent involves the danger of diminishing the inducements to accumulation of capital; or, more immediately, of driving capital abroad, if the principle is applied in one country only. And the danger is much greater here than in the case of the partially distributional interferences noticed at the close of the preceding chapter, because if the principle is applied at all, any limit to its application seems quite arbitrary; if the burden of the rich is to be twice as great as that of the poor, there seems no clear reason why it should not be three times as great, and so on. Accordingly most economists¹ hold that any such communistic tendency should be rigidly excluded in the adjustment of taxation; and that whatever government may legitimately do to remedy the inequalities of distribution resulting from natural liberty should be done otherwise than by unequal imposition of financial burdens. And this is, in the main, the conclusion which I am myself disposed to adopt; but I must interpret or limit it by one important proviso which seems to me necessitated by the acceptance of the

¹ Including, I suppose, J. S. Mill—though I do not exactly see how to reconcile the following statements, which I find in separate paragraphs of his Book V. chap. ii. § 2:

“Whatever sacrifices a government requires should be made to bear as nearly as possible with the same pressure upon all”...

“The true idea of distributive justice consists not in imitating but in redressing the inequalities and wrongs of nature”...

principle that the community ought to protect its members from starvation—a degree of communism which, as we have seen, is legally established in England, and practically admitted, in one form or another, by modern societies generally. It seems to me to follow from this that, if possible, no one's income should be reduced by taxation below what is required to furnish him with the bare necessities of life. For if Government is to risk a serious instalment of the evils of communism in order to secure all members of the community from starvation, it hardly ought to aggravate its inroad on the motives that normally prompt the poor to energetic industry, by *taking* from those who remain independent a part of what it would actually have to give them if they sought its aid. And if on this ground we exempt altogether from taxation incomes below a certain low limit, it would be obviously unreasonable to exact a full quota of payment from those just *above* this minimum; for this would lead to the absurd result that persons who could only earn a very little more than the minimum would lose the *whole* of such extra earnings. It seems therefore that we ought to treat as taxable only that portion of any individual's income which is not required to provide necessities either for himself or for those dependent on him; at least in a community where the principle of the English poor-law is accepted. And even apart from any question of poor-relief, I think that this principle of adjustment would tend to realize equality in the distribution of the burden of taxation more nearly than the rule of proportioning taxation to income; since deprivation of the necessities of life is an evil so indefinitely greater than deprivation of luxuries that the two may be fairly treated as incommensurable; and we may assume generally that if poor and rich alike are deprived of a certain proportion of their resources available for luxurious expenditure, the loss thus incurred of purchaseable satisfaction will be at least as great to the poorest class that will be taxed at all, as it will be to any other class. The question, I think, is rather whether even this principle is not oppressive to the poor; and whether in order to equalize the real burden of taxation we ought not to lay a progressively increasing tax on the luxurious expenditure of the rich; and I must admit that, in my opinion, such a tax would be justifiable from the point of view of distri-

bution alone: but it is open to the practical objection that the progression if once admitted would be very difficult to limit, owing to the impossibility of establishing any definite quantitative comparison between the pecuniary sacrifices of the rich and those of the poor; and therefore there would be a serious danger that the progression would be carried so far as to check accumulation or drive capital from the country¹, thus causing a loss to production which would more than outweigh the gain in equalisation of sacrifice.

If, however, we allow strict equity in the distribution of taxation to be overborne in favour of the rich by the advantage of encouraging the accumulation of capital in the country, it seems reasonable to aim at the same result more directly by a measure that will operate generally in favour of those who derive their income mainly from labour: viz. by exempting savings from taxation. A certain minimum of savings, indeed,—enough to prevent individuals from becoming a burden to others in age or sickness—should be included in the exemption of necessaries argued in the preceding paragraph. Further than this there would be no ground for carrying the exemption, if what were saved were merely hoarded, in the form of coin or durable consumer's wealth; since the portion of wealth that at any given time was so hoarded would at the time be merely employed in gratifying the hoarders by giving them a sense of power or security; and there would be no reason why these personal gratifications should not bear along with others the reduction required to supply the needs of government. But, actually, since what is saved takes mainly the form of capital that aids industry, the saver,—whatever his motives may be—does in fact render an important service to production; and it seems desirable that this should at least be as little as possible discouraged by taxation.

But again; if we exempt savings on this ground, it seems reasonable to extend the exemption to what is spent by a father of a family on the education of his children, so far as it tends to make them more efficient labourers. And there would seem to

¹ The latter of these would be the immediate practical danger, as it is not likely that such unequal taxation of the rich would be introduced in most civilised countries simultaneously.

be even stronger grounds for encouraging by a similar exemption the devotion of funds by gift or bequest to public objects of real utility, provided that adequate security is taken that they are efficiently administered; especially if the objects are of a kind to which public money might reasonably be allotted, if private liberality were wanting. It may even be plausibly urged, that a considerable part of the non-necessary expenditure of the rich is actually incurred in maintaining and transmitting culture, and that this also is a function of sufficient social importance to be properly encouraged by exemption from taxation. This consideration is, I think, not devoid of force, in spite of the great difficulty of distinguishing expenditure of this kind from that which ministers to mere personal enjoyment; and the expediency of providing for this and the other exemptions before mentioned seems to me a strong reason for throwing a large share of the burden of taxation on the consumers of commodities that are neither necessary nor promotive of culture; provided that this can be done without material disadvantages of some other kind. Such taxes on commodities, however, tend to be seriously unequal; especially since there are very strong technical reasons for concentrating such taxation on a few articles largely consumed, in order to minimize the cost—financial and extra-financial—that it involves; and it is almost inevitable that the expenditure on these particular articles should form a very variable proportion of the total expenditure of different classes of the community on things that are neither necessities nor promotive of culture. So far as the classes thus over-burdened can be distinguished as those receiving incomes of certain amounts, the inequality may be roughly compensated by an income-tax on other classes—as it is in the English budget—; but there are still liable to remain great variations in the consumption of taxed commodities among persons of similar incomes—owing to variations of taste, constitution, &c.—for which it is practically impossible to make compensation. The adoption, therefore, of this method of raising taxes must be admitted to be incompatible with any very exact equalisation of the burden of taxation. But in fact any such exactness is rendered practically unattainable, on the general principle above adopted, by the vagueness of the distinction between necessities and luxuries, and the great

differences in the needs of different persons and of the same person at different times; and the method of taxing commodities has the merit of avoiding the worst inequalities which taxation proportioned to income would cause, in consequence of these differences of need; since it enables those persons whose needs are greatest to diminish their share of taxation, by abstinence from customary luxuries.

Generally speaking, it is desirable to select for taxation commodities of which the consumption is not likely to be restricted to any great extent, through the desire to avoid payment of the tax, as all such restriction increases the excess of the loss to the public caused by the tax, over and above the gain to the treasury; since the persons who are driven to consume commodities which they do not like so well suffer a manifest loss of utility. But there is one exceptional case, very important in our own system of taxation, in which this principle does not apply: viz. where the commodity taxed is largely consumed in excess of what is salutary. So far as such excess is prevented by the tax, the restriction of consumption is positively beneficial to the community; and though legislative interference with the sole object of limiting the consumption of dangerous commodities is emphatically condemned by advocates of natural liberty, they have not, for the most part, pushed their antagonism so far as to maintain that the selection of taxes ought not to be partly influenced by this consideration. On the other hand, the burden of such taxes—as those on alcoholic liquors and tobacco—is liable to fall with special inequality on different members of the same class; since not only do many persons shun these dangerous commodities altogether, but among those who consume them the standard of strict moderation is vague and variable, and there are many degrees of excess possible. It has been plausibly suggested that the extra contribution levied from the drunkard should be regarded as a fine¹ rather than a tax: but if this be admitted, the difficulty of drawing a clear line between moderate and immoderate drinking introduces a new and peculiar uncertainty into the problem of determining the actual distribution of taxation; especially since there are many

¹ As suggested by Mr Dudley Baxter, *Taxation of the United Kingdom*, ch. xxi.

other branches of luxurious consumption in which indulgence is liable to pass the limit of moderation, and in which excess is unsalutary, though not so palpably hurtful and dangerous to society.

§ 8. So far we have implicitly assumed that taxes on commodities can be so imposed as to fall entirely on those who consume them; and similarly that an income or property tax will be borne by the persons on whose income or property it is laid. We have now to notice a new element of imperfection and uncertainty in the equalisation of taxation, due to the fact that we can only partially succeed in making the burden either of 'direct' or 'indirect' taxes fall where we desire; the burden is liable to be transferred to other persons when it is intended to remain where it is first imposed; and, on the other hand, when it is intended to be transferred the process of transference is liable to be tardy and incomplete¹. Indeed this process is often so complicated and obscure that it is a problem of considerable intricacy and difficulty to ascertain where the burden of a tax actually rests: and it is not even a simple matter to state accurately the general principle for determining the incidence of a tax, supposing all the facts were known:—as is evident from the fact that Mill has not been able to arrive at a perfectly consistent view on the subject. Thus he maintains (B. v. ch. iii. § 3) that a tax on profits, even when through the stimulus it has given to invention it has "been realized without loss to any one," must be still "considered as paid from profits, because the receivers of profits are "those who would be benefited if it were taken off"—thus apparently holding that the incidence of the benefit of remission is a trustworthy criterion of the incidence of the burden of the tax. But in ch. ii. § 6 he affirms that "there is not the "smallest pretence for looking on" the existing land-tax in England "as a payment exacted from the existing race of land-lords:" though it must be evident that it is the existing race of landlords who would benefit by its remission. And in fact his criterion is neither plain nor always trustworthy. In

¹ The common classification of taxes as Direct and Indirect appears to me liable to mislead the student, by ignoring the complexity and difficulty of the problem of determining the incidence of taxation.

some cases, as we shall see, the persons who would reap the whole benefit of the remission of a tax have never suffered from its imposition; while, more frequently, both benefit and burden tend to be wholly or partially transferred after a varying interval of time, so that the real incidence of the tax may be quite different at different periods from the date of imposition or remission.

For this reason, we cannot, I think, say that it is the extra income that the man who pays the tax would gain if it were taken off which gives the true measure of the burden it imposes on him, but rather the extra income that he would now be enjoying if it had never been laid on. But to get even an approximate estimate of this hypothetically determined burden may require a very careful consideration of complex consequences; and the result must often be at the best but partially satisfactory. I will indicate by taking the most important cases the kind of consideration that is necessary.

To begin with the simplest.

I. A special tax on a class of persons, distinguished by characteristics either irremovable or of no economic importance, tends to be wholly borne by the persons who pay it. This would be the case (e.g.) with a tax on Jews or Papists; for even if some of the Jews left the country in consequence, or some of the Papists became Protestants, the exchange value of the services of the remainder would not thereby be materially increased.

II. Taxes of the above kind are opposed to modern sentiments of equity. A nearly similar inevitability, however, attaches to a general tax on incomes, simply proportioned to their amounts, so long as it is not heavy enough to induce any particular class of the persons on whom it is imposed to diminish materially the relative supply of their labour; either voluntarily, through emigration or abstinence from matrimony, or involuntarily in consequence of the resources of their families being reduced below the minimum required to support life. But if any considerable diminution in the relative numbers of any class takes place through these causes, it will tend to raise the market value of their labour to some extent, and to that extent to transfer the burden of the tax to other members of the com-

munity; but obviously with very different degrees of rapidity, according as the effect is produced (1) by emigration, or (2) by abstinence from matrimony or inability to rear children. Similar consequences may of course follow from any taxation that falls specially on the poorer classes of labourers; hence there is an element of truth in the old doctrine that "taxes on wages tend to fall on profits¹," if applied to the wages of unskilled labour, supposed to be already at the minimum required to "enable the labourers, one with another, to subsist and perpetuate their race." And some effect of this kind might no doubt be produced even by taxes proportional (as above proposed) to non-necessary expenditure: but, unless such taxes were extremely heavy, it would generally be of so indefinite and remote a kind as not to be practically worth estimating.

III. A tax annually levied on the owners of any particular kind of durable wealth, of which the supply is absolutely limited, will remain onerous to the persons on whom it was originally imposed even after they have sold the article taxed. For instance if Raphael's pictures were thus taxed, the amount of the tax capitalised would tend to be subtracted from their price, so that, after a single transfer by sale, the tax would not be really onerous to the person who actually paid it. A similar effect will be produced by a *special*² tax on land of fixed amount, not increasing with its value or rent: so far as land has changed hands by sale since its imposition, the burden of the tax will be no longer borne by the actual landowner; and therefore even if the tax was originally unjust, the actual landowner will in such case have no claim to its remission. Hence where such a tax is of old date, so that a considerable amount of land has changed

¹ Though in fact the burden thus transferred would be divided among (1) the employers of the labour grown dearer, (2) the consumers of its ultimate products, (3) labourers in other grades, and (4) owners of capital in proportions which will vary very much according to circumstances; and which, I may add, would be very difficult to ascertain with even approximate accuracy in any concrete case, owing to the intermingled effects of other causes.

² The effect of a tax on land which is merely one form of a more general tax on property or income will be quite different, since in this latter case the selling price of the land will not tend to be lowered, as its purchaser will have to pay no more taxes in consequence.

hands by sale,—and all by inheritance¹,—since its original imposition, it seems best not to regard it as really a tax at all, but as a share of the rent of land reserved to the community; just as if it had been a payment imposed when the land was allowed to pass into private ownership.

IV. When, however, a special tax is imposed on land, varying in proportion to its value, the case is different, and the incidence of the tax more complicated; and it may be of some practical interest to examine it in detail, on account of the special burdens laid on land and houses—which may be regarded as a particular form of utility added to land—in our system of local taxation. At any given time there is a certain amount of outlay of various kinds for the purpose of increasing the utility of land, which would, apart from the tax, be remunerative; but a portion of which will be unprofitable, if the tax be imposed, unless the price of the produce of land rises. Hence the imposition of the tax will tend to prevent this portion of the outlay from being made, and so to restrict the supply of the consumable utilities that would have resulted from it, and consequently to raise their price somewhat; but the extent of such rise will vary indefinitely according to the conditions of supply and law of demand for the produce in question. If (e.g.) the producers are closely pressed by foreign competition, the rise may be very slight; while, if the produce cannot be imported and the demand is inelastic, the price may ultimately be increased by nearly the whole amount of the tax. But to whatever extent the price rises from this cause², the burden of the tax will be ultimately transferred to the consumer or purchaser of the utilities furnished by the land; i.e. to the occupier (who may, of course, be actually the owner) of land used for enjoyment (parks, gardens, &c.), or to the purchaser of the produce of agricultural land,—who, however, if he be a purchaser not for consumption but for sale or production, may, under certain conditions hand on the burden still further, till it reaches what we may call the ultimate consumer.

¹ Cf. *post*, § 11 where the peculiar economic characteristics of taxes on inheritance are pointed out.

² Here again, it will generally be very difficult to ascertain in a concrete case, how far any rise in price has actually been due to this cause.

The initial operation, however, of such a tax may be somewhat further complicated by its effects on the business of producing the increased utility of the land. To illustrate this complication, we may take the specially important case of land used for building. Suppose that a new tax proportional to value—not balanced by corresponding taxes on other sources of income—is laid on owners of land generally, including owners of land with buildings on it; and suppose for simplicity that the tax is annual and rent is competitively determined afresh from year to year. Then, as the imposition of the tax cannot at once affect the supply of houses or the demand for them, the whole tax will at first tend to be paid by the owner; so that the building of houses will become less remunerative, and will consequently be reduced in extent. The resulting limitation of supply—as houses cannot profitably be imported—will tend to raise their price and rent sufficiently to make building remunerative; that is, if the cost of building were unaltered the rent would tend to be increased by the amount of the proportion of the tax that falls on the rent of the building as distinct from the ground. But in fact, if the tax be a heavy one, the rise will tend to be temporarily somewhat less than this; since the cost of building will undergo some reduction in consequence of the check given to the building industry by the tax, which will tend to diminish for a time the returns to the labour and capital employed in this industry¹. Ultimately, however, the whole portion of the tax that is paid for the value of the house itself, will fall—in the case of private dwelling houses²—on the consumer or occupier. The portion, however, that falls on the ground-rent will continue to be borne by the owner of the ground (supposing, as above explained, that he has not sold it) unless the tax has caused a rise in agricultural

¹ If the tax were a very heavy one, a sensible though fainter effect of the same kind might also be produced on other industries auxiliary to the building trade: so that a small temporary wave of loss, diminishing in intensity as it extends, would spread through the group of industries connected with building.

² So far as the tax falls on buildings used as producers' capital, it will have a certain tendency to be transferred through industrial competition; but the incidence of the tax supposed will be so general that the extent and manner of its possible transfer is very difficult to determine—especially since producers who use land will be more heavily taxed.

produce and the land is so situated that it could be as remuneratively employed for agricultural purposes as for building. Nay further, if the tax be not uniform but higher in some districts than in others, the whole excess—and not merely the proportion of the excess that falls on the ground-rent,—will tend to remain on the owner; at least so long as the fall does not render the land more profitable for other purposes than it is for building.

So far I have supposed the tax to be formally paid by the owner. If, however, it be laid in the first instance on the occupier, the effect will be substantially the same as soon as the rent comes to be determined afresh, after the imposition of the tax.

§ 9. V. In short, a tax on land and buildings proportional to their value has partly the effect of a tax on the product of certain industries: partly, again, so far as the land or buildings taxed are 'producers' wealth' it has the effect of a tax on the instruments of certain industries. To whatever extent it operates in either way, it comes within the large class of what we may call Taxes on Production; which occupies the most important place in modern systems of taxation. This class includes, besides (1) the important taxes before referred to on the manufacture and sale of material products, also (2) taxes on conveyance, (3) payments (fees, licenses, &c.), for leave to practise certain trades and professions, and (4) a great part of the taxes (by means of stamps) on the transfer of property—so far as these, falling with more weight on traders, may be regarded as largely taxes on trade. Such taxes on special lucrative callings are generally intended to fall, not on the persons who exercise them, but on the ultimate consumers of the commodities that the former furnish, or assist in furnishing; and it is obvious that industrial competition will tend to cause this transfer of the burden, so far as it tends to equalize remunerations. Still the transfer ought not to be assumed, in estimating the incidence of taxes, without important qualifications. We may indeed take it as broadly true, in most cases, that the burden of a *long-established* tax on production does not rest on the class of persons who actually pay it;—though even here it must be borne in mind that, owing to the limited know-

ledge that producers have of each other's remunerations, industrial competition, however open and active, cannot tend to bring about any exact equalization of earnings; it can but operate roughly to prevent large and palpable differences. But it is only under special circumstances that a *new* tax on production can be completely and at once transferred to the consumer. For, firstly, whenever the rise in price required to effect the transfer involves a material reduction in the sale of the commodity taxed, some initial loss to producers must result; which will be greater, *ceteris paribus*, in proportion to the extent of the reduction. We have thus an additional reason for selecting, in the imposition of fresh taxes, commodities for which substitutes cannot easily be found and with which consumers will not willingly dispense, in order that the incidental loss to producers may be as small as possible. Again, the extent of loss to producers caused by a reduction in the demand for their commodities varies very much according to the degree of mobility of their capital:—thus it is usually less for traders than for manufacturers and agriculturists; which is a reason, from a strictly national point of view, for taxing imports, *ceteris paribus*, rather than the products of native industry.

But again: the tendency of industrial competition to transfer the burden of taxation from producers to consumers will not operate where the former are enjoying extra profits to an amount exceeding that of the tax; whether through monopoly, natural or artificial, or through the possession of scarce natural resources or social opportunities. Thus a moderate tax on the produce of famous vineyards would have no tendency to be transferred to the consumer; the owners of the vineyards would still produce as much as they can and get the market-price for it, as they do now, so that the whole of the tax would be substantially paid out of their incomes. Where, however, a monopoly has been constituted by means of a grant of special rights and privileges granted by government, an exceptional payment by its owners should not be regarded as, in substance, *strictly* a tax; it is rather a share in the extra profits of the monopoly reserved to the community.

It is to be noted further, that in the case of temporary and partial monopolies, protected only by the difficulties of

profitable competition, it must often be very uncertain where the burden of a tax on the monopolised production really rests, after a certain interval from its original imposition. For the tax operates as an additional obstacle to competition; and it may possibly be decisive in preventing it—but this can hardly ever be known for certain. Thus if a tax be imposed on the receipts of railways, where no other mode of conveyance seriously competes with them, the burden will primarily fall on the shoulders of the railway companies: for if it were profitable for them to raise their fares after the tax had been imposed, it would have been equally profitable for them to do this independently of the tax: the tax can give no additional motive of self-interest to adopt such a measure, except so far as it removes from them the fear of competition; and this last operation must always be of a very vague and uncertain kind.

Finally we must observe that taxes on commodities when laid in certain ways may actually benefit certain classes of the producers or sellers of such commodities, by giving them advantages in the competition with other producers. Thus a tax on the materials of production or on products in an early stage of manufacture, or on articles of trade some time before they are sold, has a certain tendency to increase the advantage of large capitalists, as it causes more capital to be required for a given amount of business. Hence it is quite possible that the consumer may even lose by such a tax, through a rise in price, considerably more than is gained by the exchequer; the employer being able to exact wages of management, as well as interest, for the extra capital employed. Licenses again, if the charge for them is fixed independently of the amount of business, are similarly advantageous to large employers.

§ 10. We have already had occasion to notice that, in a complete estimate of the incidence of a tax, we ought strictly to take into account not merely the burden laid on producers or consumers of the article taxed, but also the loss to the community through the non-production and non-consumption of the greater quantity and better quality of commodities which would have been produced if the tax had not been imposed. That is, we have to take into account those effects on production which we began by distinguishing from effects (merely) on

distribution ; so far as the former being unequally distributed, really affect distribution as well. I shall now proceed to indicate briefly the chief cases of the productional effects.

Let us take first the case of taxes on the manufacture and sale of commodities. Such taxes cause an economic loss, uncompensated by any gain to the treasury, so far as they admit of being evaded by the adoption of a less economical mode of producing the commodity ; or, again,—where this is prevented—so far as the processes of production are impaired or hampered, or improvements in them precluded, by the necessity of conforming to rules imposed to guard against evasion or otherwise for the convenience of the tax-gatherer. For instance, the production of oil in Asia Minor is said to be seriously deteriorated by the fact that the olives after harvest have to be kept untouched until the tax-collector has found time to come and ascertain their amount.

Again, we have already observed that production is affected, so far as the demand for the taxed product is decreased by its rise in price ; and that this effect will be greater *ceteris paribus* in proportion to the facility of finding substitutes for the taxed product, and thus satisfying the same wants by different means. So far as the production of such substitutes is made to replace the production of the taxed commodity, the consumer suffers an uncompensated loss similar to that caused by the adoption of inferior methods of producing the same commodity.

We may however notice that this loss will be proportionally less, if the commodity belongs to the class of which the normal expense of production increases with the total amount produced. For in this case both the diminution of production and the consequent loss of satisfaction to the consumer is lessened by the decrease in the proportional expense of producing the reduced amount.

So far as taxation of this kind reduces the normal use of materials or instruments of production, or of articles whose consumption conduces to the efficiency of productive labourers, and for which only imperfect substitutes can be found elsewhere, a loss results to production which may go on propagating itself at compound interest.

On the other hand, there are certain taxes that, in various ways, have a beneficial effect on the aggregate wealth of the country. Thus, as we before noticed, taxes that reduce the consumption of commodities liable to be abused, such as alcoholic stimulants, may indirectly increase production by diminishing the loss of efficiency caused by such production. And of course, so far as consumers are thus prevented from injuring themselves, their total satisfaction is increased by what is primarily a privation.

We may notice again the special advantage that results from taxing things that are partly esteemed as signs of wealth, and therefore of social status: since a tax imposed on such articles *pro tanto* increases their utility in proportion as it increases their exchange value; so that the consumers do not lose what the Government gains.

And, finally, it must be admitted that the imposition of import duties is, under certain circumstances, a method at least temporarily effective of increasing a nation's income at the expense of foreigners—though on various grounds a dangerous method: and the same is true of export duties, whenever a country has a monopoly of any product keenly demanded.

The effects resulting from the other kinds of taxes on lucrative occupations are for the most part similar to these. Taxes on conveyance, so far as they hinder the transfer of commodities, tend to prevent such improvements in production as result from the specialization of the labour of different places; and similarly, so far as they hinder the transfer of labour, they tend to prevent its most efficient employment. So again, the stamp duties on bills of exchange, receipts, drafts, &c., have a tendency to hamper the development of trade; though this effect seems inconsiderable, so long as such duties are trifling in proportion to the amount of the transactions on which they are imposed.

We have now to notice that important effects on production are caused by other taxes besides those that fall primarily on producers. In the first place, it is clear that direct taxes on expenditure, such as the taxes on carriages, horses, plate, so far as they reduce the consumption of these commodities, affect their production ultimately—though not altogether at the first imposition—to the same extent as corresponding taxes on the

production of these articles¹. These effects—generally disadvantageous—are avoided by a direct tax on incomes², but even an income-tax—as well as any other that diminishes the available resources of individuals—is liable to affect production generally, so far as it reduces the amount saved and converted into capital. And this effect cannot be altogether prevented by proportioning taxation (as before proposed) not to income as a whole, but to income with savings subtracted; since the encouragement thus given to save may be practically much less important than the diminution in the power to save which the tax inevitably causes. On the other hand, when the proceeds of a tax taken mainly from what would have been luxuriously consumed by individuals are productively employed by Government, it may be regarded as a mode of compulsory saving, by which the capital of the *community*—though not of individuals—may be materially increased.

It may be observed further that, so far as saving is an affair of habit, a tax may actually cause a diminution in it not due to its amount, but to the nature and circumstances of its incidence. Thus it has been plausibly maintained that the taxes on inheritance of property have a special tendency to produce this effect; because the person inheriting ordinarily considers the additional wealth thus acquired as an increase of capital, and does not spend any portion of it, but only increases his expenditure by the annual interest on it.

§ 11. This leads us to the more general question of the incidence of taxes on the acquisition of property by bequest or intestate inheritance; which I have reserved for separate consideration, because of the important peculiarities that they present, when we are considering the theoretical construction of a system of taxation. According to the criterion above laid

¹ Hence a certain share of the burden of these taxes, at least when newly imposed, will under most circumstances be borne by persons engaged in the production of the commodities taxed: no less than in the case of the 'indirect' taxes, discussed in the preceding section.

² The peculiar drawbacks of an income-tax, arising from the difficulty of obtaining an accurate estimate of the incomes of individuals, belong to a more technical discussion of the problem of taxation than I have here attempted.

down, it is plain that the pecuniary loss caused by any such tax falls on the person who inherits, since he would have been richer by the exact amount of the tax, if that had not been imposed; except so far as it is probable that the person from whom he inherits, being aware of the tax, may have left him a larger property in consequence—a probability which, I imagine, is not practically important in the case of most of the property obtained by inheritance.

Nevertheless, the considerations that ordinarily would lead us to limit carefully the burden of taxation falling on any individual or class do not, I conceive, apply in the case of persons taxed as inheritors. For Government, by taking a portion of what would otherwise have come to a man by inheritance, in no way diminishes the motives that prompt him to produce and accumulate wealth—if anything, it tends to increase these motives; nor does it necessarily cause even any disappointment of expectations, except when the tax is first imposed. On the other hand we ought undoubtedly to take into account the diminution in inducements to industry and care which a heavy tax on inheritances may cause, in the view of persons who look forward to leaving them. The bad effect of such taxes, however, in this way is not likely to be at all equal in proportion to the similar effect that would be produced by extra taxes on income; in fact the limits of taxation on inheritances will be practically determined for the financier rather by the danger of evasion through *donationes inter vivos*, than by the danger of checking industry and thrift: and either danger will generally be much less where there are no children or other direct descendants to inherit. Hence it seems expedient, in the case of these taxes, to give up the ordinary aim at equality of incidence so far as to place a much heavier tax on wealth inherited by persons not in the direct line of descent from the previous owners. But if this course be adopted, it becomes theoretically almost impossible to include these taxes in an adjustment of general taxation on the principles of distribution before proposed: and it seems to me not only convenient but equitable to treat these taxes as a special burden on the class of persons owning capital in considerable amounts—

inheritances below a certain value being exempted¹. For, as was before said, the proportionment of taxation to non-necessary expenditure seems certainly to make the burden of *sacrifice* imposed on the poor heavier than that of the rich, though the excess does not admit of being definitely estimated; and it seems equitable to balance this excess roughly by the special burden that taxes on inheritance will lay on the rich.

Bequests to public objects of manifest utility should, I conceive, be exempted altogether from taxation proper—as distinct from payments for services received—since any diminution of these bequests that might be caused by the taxation would, by supposition, be a clear loss to the community. But in proportion as the real utility of such bequests becomes doubtful, the advantage of exempting them from taxation becomes also questionable.

¹ This exemption is expedient on other grounds besides that which I proceed to urge: viz. in order to encourage thrift among the poor, and on account of the greater proportional cost of collecting the tax on small inheritances.

CHAPTER IX.

POLITICAL ECONOMY AND PRIVATE MORALITY.

§ 1. We had occasion to notice in the last chapter but one, that in considering some important departments of governmental interference it is practically necessary to take account of the unconstrained action of private persons for public objects. We cannot determine what Government ought to do without considering what private persons may be expected to do; and what they may be expected to do will, to some extent at least, depend on what it is thought to be their duty to do. And, more generally, it was before observed that in the performance even of the ordinary industrial functions with which economic science is primarily concerned men are not merely influenced by the motive of self-interest, as economists have assumed, but also extensively by moral considerations. Hence it would seem that an Art of Political Economy is incomplete without some consideration of the principles that ought to govern private conduct in economic matters. But for a complete treatment of this subject, it would seem needful to begin by establishing systematically certain principles of morality, and then considering the relation of these to the principles of Political Economy as expounded in the present treatise—a procedure which would inevitably introduce the fundamental and unsettled controversies of ethics to an extent that would be hardly suitable in the concluding chapter of a work on Political Economy. I therefore propose in this concluding chapter to confine myself to a brief reflective survey of the manner in which the morality of common

sense has actually been modified by economic considerations, only trying here and there to introduce somewhat more clearness and precision than appears to be found in ordinary thought.

It is generally recognised that the current economic doctrines, and the prevalent habits of thought connected with them, have had an important effect in modifying that part of current morality which is concerned with the getting and disposing of wealth—otherwise than by merely enlightening and rationalizing the pursuit of private pecuniary interest; which, indeed, English Political Economy has for the most part rather assumed to be enlightened than sought to improve by instruction. The department of duty in which this influence has been chiefly noticed is that of liberality or charity. By many persons “hardhearted Political Economy” has been vaguely believed to dry up the sources of almsgiving; and it is undoubtedly true that almsgiving under certain conditions is shewn to be opposed to the true interests of the community by economic arguments fundamentally similar to a portion of those on which the inexpediency of legally enforced communism is usually rested. It is less commonly observed—though it is, I think, no less true—that economic considerations have had an important share in defining the current conceptions of the more stringent duties of Justice and Equity: and it will be in accordance with the received order of ethical discussion to begin by considering these.

To begin with an uncontroversial definition of Justice—we may perhaps say that “just” claims to wealth or services are claims precise in their nature, for the non-fulfilment of which a man is liable to strong censure, if not to legal interference; indeed we should agree that such claims ought to be capable of legal enforcement, if the benefits of this were not in some cases outweighed by the incidental difficulties and drawbacks of judicial investigation and governmental coercion—as is (c.g.) largely the case with the mutual claims of members of a family. The line between Justice and Equity is not sharply drawn in ordinary thought; but so far as we distinguish from strictly just claims those that we should rather call “fair” or “equitable,” the latter would seem to be less definite and more frequently beyond the sphere of legal intervention, but yet claims for the

fulfilment of which gratitude is not to be expected, while their non-fulfilment is blamed.

Both kinds of claims without distinction may be conveniently classified according to their sources as follows: besides (1) claims determined by law independently of contract, with which we need not here concern ourselves, the most important class is (2) that of claims arising out of contract, express or tacit—the notion of “tacit contract” being extended to cover all normal expectations which a man knows (or ought to know) will be produced by his conduct in the minds of others. Such expectations are of course largely determined by custom: while in (3) a certain class of cases custom practically restricts freedom of contract—as in the case of fees to a physician. Further, there are (4) claims arising out of previous services rendered under circumstances under which contract would have been impossible or inexpedient; such as the claims of parents on children: and (5) claims to reparation for harm inflicted; along with which we may class claims to the prevention of harm, where A has done an act which *would* injure B if no provision were made against its harmful consequences. Under this last head would come the claims of children on parents for sustenance and nurture during infancy.

The influence of Political Economy is, I conceive, chiefly noticeable as regards the second and third of these classes. In the first place the ‘orthodox’ ideal of free exchange is necessarily antagonistic to the sway of custom as such—except so far as a customary determination of the price of services, modifiable from time to time by changes in supply and demand, is economically advantageous by saving time and trouble. But, as I have already observed, in a modern industrial community custom can hardly be regarded as an effective economic force, except so far as it blends with tacit combination—or, I should perhaps say, tends to turn into combination when resisted. If A pays B for certain services a customary price which he believes to be above the competition price, it is generally under the condition of both being aware that the majority of B’s fellow-labourers would if necessary combine with him in refusing to accept a lower price. How far Political Economy, considered as an Art or a doctrine of what ought to be, approves of Com-

binations to raise prices, when prompted by self-interest, I will presently consider: meanwhile there seems no doubt that the influence of economic discussion has tended to invalidate all quasi-moral obligations founded on customs pure and simple, substituting for customary terms of exchange conditions determined by definite agreements freely entered into.

The duty of observing such engagements was so clearly recognised in pre-economic morality that it can hardly be said to have been made any clearer through the teachings of economists, though no doubt these have dwelt with strong emphasis on the fundamental importance of this department of morality in a modern industrial community. It is rather in the determination of certain doubtful points that arise when we try to define exactly the conditions under which an agreement is to be regarded as really embodying the free choice of both contracting parties, that the influence of political economy appears to be traceable. It is admitted that, generally speaking, any 'really free' exchange of commodities which the exchangers have a right to dispose of is legitimate and should be held valid, and that 'real freedom' excludes (1) fraud and (2) undue influence: but how are we to define these latter terms? Is A justified in taking any advantage that the law allows him (1) of the ignorance and (2) of the distress of B—supposing that A is not himself the cause either of the ignorance or of the distress? If not, to what extent is he justified in so doing? In the answers that thoughtful persons would give to these questions we may, I think, trace the influence of economic considerations, limiting the play of the natural or moral sentiments of sincerity and sympathy.

To begin with the case of ignorance: we should not blame A for having, in a negotiation with a stranger¹ B, taken advantage of B's ignorance of facts known to himself, provided that A's superior knowledge had been obtained by a legitimate use of diligence and foresight, which B might have used with equal success. We should praise A for magnanimity if he forbore such advantage: but we should not blame him for taking it, even if the bargain that B was thus led to make were posi-

¹ I say "a stranger," because even a slight degree of friendship between the parties would render such a bargain a betrayal of implied confidence.

tively injurious to the latter, supposing that the injury would otherwise have fallen on A, so that there is only a transfer and not an increase of damage. For instance, we should not blame a man for selling in open market the shares of a bank that he believed was going to break, if his belief was founded, not on information privately obtained from one of the partners, but on his own observations of the bank's public acts or on the judgment of other experienced outsiders. Again if a man has discovered by a legitimate use of geological knowledge and skill, that there is probably a valuable mine on a piece of land owned by a stranger, reasonable persons would not blame him for keeping the discovery secret until he had bought the land at its market value. And what prevents us from censuring in this and similar cases is, I conceive, a more or less conscious apprehension of the indefinite loss to the wealth of the community that is likely to result from any effective social restrictions on the free pursuit and exercise of knowledge of this kind. Such use of special and concealed knowledge is only censured by thoughtful men, either (1) when it is for some particular reason against the public interest—as (e.g.) if members of a cabinet were to turn their foresight of political events to account on the Stock Exchange—; or (2) when the person using it has obtained it in some way having a taint of illegitimacy—as by betrayal of confidence, intrusion into privacy, &c.—; or (3) when the person of whom advantage is taken is thought to have some claim on the other beyond that of an ordinary stranger.

§ 2. Let us now consider the question that arises when we try to define the moral coercion or undue pressure that renders a contract unfair: viz. How far A may legitimately take advantage of the urgent need of B to raise the price of a commodity sold to the latter, supposing that he is in no way responsible for this urgent need? The question is one, I think, of considerable practical perplexity to ordinary minds; and it requires some care in distinction and analysis of cases to give even a tolerably satisfactory answer to it. In the first place, where B is under the pressure of exceptional and sudden emergency, in which A has a special opportunity of rendering assistance, while the need is so urgent that there is no room for competition to operate, it seems certain that A would be generally blamed for exacting

for his service the full price which it is B's interest to pay : and this would not only be true in cases of danger to life or health, where humanity seems more obviously to dictate unbargained assistance, but even where it is a mere question of saving property. For instance we should consider it extortionate in a boatman, who happened to be the only man able to save valuable works of art from being lost in a river, to demand for his services a reward manifestly beyond their normal price : that is, beyond the price which, under ordinary circumstances, competition would determine at that time and place. Still, it is by no means clear that such extortion is "contrary to the principles "of Political Economy" as ordinarily understood. Economists assume in their scientific discussions—frequently with more or less implied approval of the conduct assumed—that every enlightened person will try to sell his commodity in the dearest market : and the dearest market is, *ceteris paribus*, wherever the need for such commodity is greatest. If therefore, the need of a single individual is specially great, why should not the price demanded from him rise proportionally ? It appears to me that it is just at this point that there is a palpable divergence between the mere abstract exposition of the results of natural liberty which deductive economic science professes to give, and the general justification of natural liberty which Political Economy is traditionally held to include, and upon which its practical influence largely depends. Enlightened self-interest, under the circumstances supposed, will prompt a man to ask as much as he can get : but in the argument that shows the play of self-interests to lead to just and expedient results it is assumed that open competition will prevent any individual from raising his price materially above what is required for a due reduction of the demand. The price as thus determined competitively in an ideal market presents itself as the *fair* or morally *right* price, because it is obviously an economic gain that the supply of any commodity should be transferred to the persons who value it most and *primâ facie* just that all suppliers of similar commodities should be paid the same. In exacting as much as this, the self-interest of the seller seems to be working as a necessary factor in the realisation of the economic harmony of society ; but any further exac-

tion which an accidental absence of competition may render possible shows egoism anarchical and discordant, and therefore no longer under the ægis of economic morality.

The conclusion, then, would seem to be that while it is extortionate in an individual to take advantage of the exceptional need of any other individual to drive a bargain with him on harder terms than he could obtain if competition were effectively open, it is not generally unfair for a class of persons to gain competitively by the unfavourable economic situation of any class with which they deal—at least when this situation is not due to sudden calamity incapable of being foreseen, but to the gradual action of general causes, for the existence of which the persons who gain are not specially responsible. If such causes diminish seriously the social value of the services of any class, some change in their industrial position is undoubtedly required in the interests of the community; but the corresponding diminution of their remuneration is a natural method of bringing about this change—a method which, though painful, is so manifestly efficacious that morality hesitates to interfere with it by censuring the persons whose self-interest prompts its application. I say “hesitates,” because in extreme cases, as where labour is remunerated at a rate insufficient to support life, strong censure is undoubtedly passed by the unreflective moral sentiment of the community; and such censure may perhaps be justified on reflection, if it is applied with due discrimination and sufficient extension of range. If we condemn “sweaters,” slop-shop dealers, and other small traders who grind the faces of the poor by taking full advantage of competition, it should be rather for want of benevolence than for want of justice; and the condemnation should be extended vaguely to all persons of wealth and leisure who are aware of this disease of the social organism and are making no efforts to remove it. Or, at any rate, if we cannot but hold the employer who gives the insufficient wages as more blameworthy than any rich man who, removed from the struggles of business, lives delicately and decorously on the interest of his capital, it is not because the former can be strictly said to owe the labourer more; but because having special opportunities for relieving his distress, he does not seize them.

§ 3. There is another question remaining. If, on the grounds above explained, the fair price of a commodity is the price that an ideal competition would determine, it seems to follow that a monopolist who raises his prices by an artificial restriction of his commodity—not merely availing himself of the advantages of natural scarcity—is to be disapproved as deliberately sacrificing common to private interest. And I think some degree of disapproval is generally felt for this procedure; except so far as the total reward thus obtained by the monopolist is thought to be possibly not more than a normal remuneration for the total labour and outlay that he has been required to give in order to bring his commodity to market—as may easily be the case with monopolies secured by patents or copyrights. I am not sure, however, that the teaching of ‘orthodox’ Political Economy has actually tended to support this disapproval; because it has often produced a blind confidence in the economic harmony resulting from natural liberty, which has obscured men’s perception of the opposition between the pecuniary interests of a monopolist—even when the monopoly is natural—and those of the community. This opposition, I think, has been more clearly seen in cases where the monopoly results from combination: the raising of prices by “rings” is held to be ‘sharp practice’ by many traders and by the general sense of non-traders. In recent times, indeed, a disposition has prevailed among philanthropic persons to exempt from this disapproval combinations of workmen to raise wages, even when these have been seen to involve some restriction in the supply of the commodity furnished by the combining workmen; but there are various special reasons for this exception. 1. So far as such combinations have aimed at resisting a fall in wages rather than obtaining a rise, the result sought—though no less divergent from the normal effect of competition—has not offended the moral sense of the community; partly from a general sympathy with the distress caused by loss of income, and a sense of the advantage of protecting the incomes of labourers from the fluctuations that the changes of modern industry naturally bring with them; partly too, perhaps, because the old pre-economic identification of ‘customary price’ and ‘fair price’ has not altogether lost its influence even with the disciples of economists.

2. Even when combinations of employed labourers have aimed at raising wages, the effort has usually been made when their employers have been believed to be making profits above the average; and a vague notion of implied partnership among producers lends to this attempt a certain air of resistance to unfair division of gains among partners. 3. The difficulty of preventing combinations of employers—especially tacit combinations—and the fact that large employers have frequently a partial monopoly from the very magnitude of their business confers on the counter combinations of the employed, to an indefinite extent, the character of legitimate self-defence. 4. Even independently of combination on the part of employers, their services tend to be purchased by society at high scarcity values, owing to circumstances before explained; and it seems not illegitimate that other persons dealing with them should make a systematic attempt to get some share of these larger gains, if this can be done in the mere exercise of freedom of contract¹.

We have seen in an earlier chapter that there are various other ways, not strictly involving violations of law or contract, in which individuals or combinations may promote their interests at the expense of the community. Thus they may raise or maintain the price of their services by increasing the need that others have of them—as when solicitors encourage litigation—or by resisting the introduction of more economical methods of satisfying this need—as when artisans combine against machinery; or again, within a margin allowed by the inevitable vagueness of their contract, they may reduce the quantity or quality of the services that they have engaged to render²; or they may make what seems, rather than what is,

¹ Cf. *ante*, Bk. II. c. IX. § 6, and Bk. III. c. VI. § 6.

² It is sometimes said that 'every workman should always do his best work;' but the principle seems ambiguous and misleading, since in fact one not uncommon mode of enlarging uneconomically the field of employment for certain kinds of labour, is to make products more finished and elaborate than is required for the purpose for which they are to be used, and to charge accordingly. The right principle seems to be that every workman should do for the purchaser of his labour the kind and amount of work which seems best adapted to the purchaser's ends, provided the latter is willing to pay the price which the requisite labour would fetch if otherwise applied.

useful, and endeavour to succeed by obtrusive advertisement rather than superior workmanship. The vague condemnation passed by the moral sense of the community on these and similar anti-social practices tends to be sharpened by a keen apprehension of their economic consequences: though it would seem to have been rather blunted than otherwise by the influence of the writings of the *laissez faire* school, owing to their too optimistic reliance on the ultimate tendency of mere self-interest to eliminate the evils condemned. It may indeed be truly said that such practices are often, in the long run, contrary to the interests of the persons who have recourse to them; but in other cases, especially when rendered respectable by custom, it seems impossible to prove that they are not really the readiest way to private gain; and certainly they are often judged to be so by the majority of persons most keenly concerned in estimating their utility for this end.

§ 4. A consideration of facts like these leads us naturally to the widest and deepest question that the subject of the present chapter suggests; whether, namely, the whole individualistic organization of industry, whatever its material advantages may be, is not open to condemnation as radically demoralizing. Not a few enthusiastic persons have been led to this conclusion, partly from a conviction of the difficulty of demonstrating the general harmony of private and common interest—even if we suppose a perfectly administered system of individualistic justice;—partly from an aversion to the anti-social temper and attitude of mind, produced by the continual struggle of competition, even where it is admittedly advantageous to production. Such moral aversion is certainly an important, though not the most powerful, element in the impulses that lead thoughtful persons to embrace some form of socialism. And many who are not socialists, regarding the stimulus and direction of energy given by the existing individualistic system as quite indispensable to human society as at present constituted, yet feel the moral need of some means of developing in the members of a modern industrial community a fuller consciousness of their industrial work as a social function, only rightly performed when done with a cordial regard to the welfare of the whole society,—or at least of that part of it to which the work is immediately

useful. From this point of view great interest attaches to the development of what is called, in a special sense, 'co-operation,' by which the conflict of interests—either (as in retail trade) between producers and consumers, or (as in the 'co-operative 'workshop,' or by means of 'Industrial Partnership') between different sets of workers engaged in the same productive industry,—has been more or less subordinated to the consciousness of associative effort for a common good. Any experiment of this kind that is economically successful is to be welcomed as a means of education in public spirit, no less than for its more material advantages.

Meanwhile it is always open to any individual who dislikes the selfish habits of feeling and action naturally engendered by the individualistic organisation of society, to counteract them in his private sphere by practising and commending a voluntary redistribution of wealth for the benefit of others. This leads me to the consideration of the influence exercised by Political Economy on the moral sentiments and judgments of instructed persons in respect of this redistribution.

§ 5. Ever since Christianity has been the established religion of Europe, thoughtful and conscientious rich persons have found a serious difficulty in providing themselves with perfectly satisfactory arguments in support of the customs of luxurious private expenditure to which they have commonly conformed, in view of the obvious happiness that might be produced by devoting their superfluous wealth in some way to increase the scanty incomes of the poor; and it is a matter of some interest to consider how far modern Political Economy has diminished or increased this difficulty. I conceive that it has operated to a considerable extent in both directions; so that its resultant effect is rather hard to ascertain. On the one hand, it has exploded the comfortable belief that the luxurious expenditure of the rich is on the whole the source of wages to the poor—it has pointed out that though labour is no doubt employed in making the luxuries, but if the money spent in them were given to the poor, labour would be no less employed in making the additional comforts of the latter; they would get, speaking broadly, the same wages and the gifts as well. Again, apart from any particular doctrines, the general habit of contemplating society in its economic aspect

tends to impress powerfully on the mind the great waste of the material means of happiness that is involved in the customary expenditure even of the most respectable and moral persons of wealth. On the other hand, though Political Economy has hardly had anything positively new to teach to experienced persons with regard to the dangers of almsgiving, it has certainly tended to make the common view of these dangers more clear, definite and systematic. It has impressed forcibly on instructed minds the general rule that if a man's wants are supplied by gift when he might have supplied them himself by harder work and greater thrift, his motives to industry and thrift tend to be so far diminished; and not only his motives, but the motives of all persons in like circumstances who are thereby led to expect a like gift for themselves. If, indeed, almsgiving could be confined to the relief of distress against which provision could not have been made, this danger would be eliminated; but it is obvious that any important and widespread source of distress, though perhaps incapable of being foreseen in any particular case, is—by the very fact of its frequency and importance—capable of being foreseen as a general probability, so that provision may be made against it by insurance or otherwise. If, finally, it be said that the poorest class of labourers have no superfluous wealth from which to make such provision, Political Economy answers with undeniable force that they can at any rate defer the responsibility of increasing the population until they have saved the minimum required for security against the pecuniary demands of ordinary calamities. It is no doubt possible for an almsgiver in particular cases to convince himself that his gift is not likely to entail any material encouragement to improvidence; but he can rarely be quite sure of this; and the general sense that care and knowledge are required even to minimize the danger has caused almsgiving to be now regarded as a difficult art, instead of the facile and applauded indulgence of the pleasurable impulses of benevolence that it once seemed to be;—an art in which even experts rarely attain perfect success while the inexperienced are liable to frequent and palpable failures, and from which, therefore, selfish, inert, or frivolous persons, if duly instructed, have a natural disposition to keep altogether aloof.

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