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PRICE MAKING IN A DEMOCRACY

through enlarging purchasing power of the general public. If unit costs are lowered by the introduction of labor-saving machinery, the displaced workers must be re-employed (though often with general shortening of hours), else labor saving becomes labor wasting, and we have merely changed our techniques without increasing total production. This re-employment is most readily effected through passing the net gain of the labor-saving technical or organizational changes on to the consumer as lower prices of products. "Probably the greatest danger in current practices of capitalistic management and organized labor is that they have depended too much on the exercise of power rather than on informed and trained judgment. . . . Collective bargaining must not be an attempt to win a point by the mere weight of numbers or strategic position. It must become an attempt to co-ordinate the resources within the administration of local executives so as to promote the maximum productivity of industry as a whole."

Chapter X began with an examination of the general idea of "price flexibility" and of price cutting as a depression cure. It arrived at the conclusion that "reductions undertaken by a producer in time of depression as a desperate expedient to induce recovery constitute bad timing and are not an exemplification of low-price policy in the sense used in this book and its predecessor." On the other hand, "Prices should not move up to exploit all the traffic will bear in the short run of boom times. The ideal time for applying low-price policy is during prosperity. It should start early and be pursued aggressively. If efficiency gains are passed on to the consumer market as fast as they can be developed, they nurture and expand consumer demand instead of blighting it; they hold the profit rate to a conservative level that rewards capital but does not encourage over-

capitalization of assets, speculative operations, boom, and collapse.”

Turning to some concrete problems of price making, we found prices after the First World War pushed up rapidly on the wave of a postwar boom that soon ended in the collapse of 1921. Likewise the course of prices in 1936-37 suggested that the failure to nurse a budding recovery along to high production volume on low prices was a contributing factor in the “disappointing recovery” from the depression of the thirties.

Coming down to the present and near future, we foresaw a situation of ready consumer demand and purchasing power after the war, but also production conditions which would permit a notable lowering of unit costs. It was argued that producers must realize these favorable conditions in the form of low prices for maximum volume of goods if we are to avoid a speculative boom and effect a satisfactory conversion from war activity to settled peacetime prosperity.

In the present chapter we shall consider several criteria of policy and action which have been used by corporation executives, to see what are the consequences to which they lead, their natural limitations, and their mutual compatibility or antagonism. We believe that such an examination reveals the need of a restatement of the traditional criteria of policy if private business management is to avoid the danger of return to such stagnation as overtook us in the thirties.

Since this chapter is the last to be presented in pamphlet form, readers are invited particularly to favor the writer with suggestions and criticisms not only of this chapter but also of any of its predecessors.

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# PRICE MAKING IN A DEMOCRACY

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## CHAPTER XI

### BASIC CRITERIA OF PRICE POLICY<sup>1</sup>

It has not been possible to carry our discussion this far without referring frequently to criteria of price policy. But these have been merely incidental comments in connection with other topics such as competition, the profit motive, democracy, responsiveness of the market, wage policy, and the timing of price changes. We shall now gather together these scattered suggestions about criteria and undertake a more systematic statement of the standards, or the tests of probable result, by which businessmen formulate their rules or acquire their practices of pricing or by which they might judge the wisdom or feasibility of new as against traditional policies. This statement will have special reference to the kind of industrial society that is to emerge after the war. (Readers who are interested in this postwar application rather than the general analysis on which it rests may turn to page 23.)

#### BUSINESS CENTERED ON "MAKING MONEY"

Common sense and every-day experience teach us that business is conducted for the purpose of making money. A given businessman may be strongly animated

<sup>1</sup>The reader should bear in mind that price policy does not mean something separate from other phases of business policy, such as technological policy, organizational policy, employment policy, wage policy, investment policy, marketing policy, that are inextricably intertwined in the business executive's total strategy of operation. But business management deals with the price aspects of these operational problems, and any penetrating and adequate analysis of business policy must therefore take price relationships as its key line of attack.

by the enthusiasm of the inventor or an almost missionary zeal to get some new form of want-satisfying goods into the hands of the largest possible number of consumers. But, as has already been observed (Chap. III, p. 1), by and large, "men do not go into business 'for their health,' but to get ahead, to make gains." To say, however, that money-making is the goal of business immediately raises three rather troublesome—and inter-related—questions: (1) How much money? (2) By what means? and (3) Money (profits or gains) for whom?

The short answer ordinarily given to the first of these questions is "as much as possible." While the minimum condition necessary if a firm is to stay in business is that its revenues must exceed its expenses, real success is measured, in the business world, by the size of that excess. A major purpose of this chapter is to examine the factors that determine how much is in fact possible.

The short answer given to the second question by actual business practice appears to be "by skill and by bargaining strength." Business concerns may make money (1) by increasing the efficiency of the technical processes which they employ (including physical layout and personnel organization); (2) by acquiring at the lowest possible prices the materials and equipment which will yield the necessary services in the business; and (3) by selecting the time and place of marketing and by gauging the quantity of product to be placed on the several markets in such ways as to take advantage of the strongest spontaneous demand and existing purchasing power or by stimulating or redirecting effective demand where this can be done at costs less than the added net revenue. Of these three means of increasing the earning power of a company, the first may be classified entirely as tech-

nological skill, the second and third as commercial skill mixed with varying degrees of trading pressure. Business profits made by the use of skill raise the efficiency of the individual firm and thus total productivity; business profits made by exerting trading strength or market control are at the expense of other firms or of consumers to whom the given firm sells or workers whom it employs.

The short answer to the third question is generally "profits for the owners." To "make money for the company" is practically synonymous with paying dividends to the owners or enlarging the value of their assets. This concept is less simple in fact than it appears in words and it is subtly intertwined (as shown by the last sentence in the preceding paragraph) with the idea of means by which profits are to be made. Hence, much of this chapter will be devoted to exploration of the issue of how the economic interests of owners, workers, and the public are interrelated and may be jointly served.

Many practical businessmen themselves qualify the objective of making as much money "as possible" by adding "decently," or with "due regard to the rights and welfare of others." These terms, however, are vague and unreliable when practical application is to be considered. They are somewhat difficult to validate to the executive who says, "business is business." At the same time they reflect a recognition on the part of the typical business executive that he has a measure of power or control, within which he can exercise discretion and pursue a policy. But they do not suggest that these executives have any confidence that economic principles can be brought to bear effectively in the guidance of that directive control.

The economist as such is not concerned with sentimental or ethical considerations which may enter into



the selection of a managerial policy. If he "sticks to his [professional] last," he too must say, "business is business." But he is concerned to discover objective criteria for charting the course of business in an environment of administered prices (and wages), continuous technological change, fickle demand, and other kinds of business uncertainty so that in fact it may be quite steadily directed toward maximum returns for each individual enterprise and for business as a whole.<sup>2</sup> In this chapter we shall endeavor to present such a formulation of criteria of business policy as the practical business executive would find useful in navigating his corporate craft amid the winds and tides of natural economic forces.

#### MAXIMUM PROFITS "FOR THE OWNERS"

At first glance it might appear that any use of technological or commercial skill means that businessmen are promoting the best allocation of scarce resources to productive use and thus moving toward the very goals that the economist would set up. The use of bargaining strength, on the other hand, has customarily been classed as "monopoly" and its harmful effect taken for granted. The real issue, however, is not what degree of control or trading strength is possessed by a given firm but the way in which this strength is employed in administering the firm's money relations with its suppliers, its employees, and its customers. If the distribution process is not properly adjusted we may have highly skilful techniques but low total use of resources, material and human. This has been described in a previous chapter (V, pages 7, 24) as the difference between qualitative efficiency and quantitative efficiency or full production.

<sup>2</sup> Whether or in what sense these two objectives are compatible will be considered later in this chapter and in subsequent chapters.

Businessmen cannot be said to have been true economizers if their making of company profits is accompanied by low utilization of plant and large amounts of unemployment.

It is a distinctive feature of our capitalistic system that the money proceeds of the business are credited on the books to the capitalist owners, to be held there as an addition to the value of their proprietary interest or to be disbursed to them as dividends. As long as business continues to be organized on the basis of private capitalism we shall continue to put maximum profits to the owners as the prime criterion of management in entering into price bargains with its wage and salaried employees, with suppliers of materials and funds, and in pricing its own product on the market.<sup>3</sup>

The first step toward making this a sound and constructive criterion is to get a firm grasp on the distinctions between profit *margin*, *rate of profit*, and *total profits*. The second is to acquire an adequate sense of the organic character of price relationships in our economic process. The third is to extend this understanding so as to embrace an adequate time perspective.

Even if one had complete control over the source from which goods of a given type are produced, he could not afford to charge the highest price that could be exacted for a single unit or a small number of units. He would maximize his profits not by exacting the widest margin per unit but by accepting such margin over

<sup>3</sup> Expressions of acceptance of this formal criterion by both businessmen and economists may be found on every hand. Two examples will suffice: "The ultimate objective of the business enterprise, as a business enterprise, is to maximize profits to the owners." (Norman S. Buchanan, *The Economics of Corporate Enterprise* (1940), p. 16.) "After all, it is the job of a corporation to make money for its stockholders." (Paul G. Hoffman, "The Corporation as a Social Instrument" in *The New Outlook in Business*, Bronson Batchelder, ed. (1940), p. 108). See also fn. 8, p. 11.

cost as would sustain a flow of sales that would give him the best rate of profit week after week and year after year.

But this raises the question as to how many years the business manager will take into account in his reckoning. It is often answered by saying that the businessman must be concerned in the whole future stream of net incomes of the corporation,<sup>4</sup> or in securing the maximum present worth of a succession of annual (or quarterly) returns. In practice, however, businessmen are often inclined to assess the uncertainties of the future so high as to set the value of future incomes very low and therefore decide to seek maximum return in a relatively short-run period. We have already referred to this tendency in the previous chapter in connection with the business cycle. Forecasting a period of low profits, no profits, or losses in the coming recession (calculated by formula), the businessman may try to exact a larger profit in the short run as a means of offsetting that prospective situation. But to secure company profits that compensate for partial idleness of plant (not seasonal) or that put unemployed capital on the dole contribute to later general unprosperity, which is bound to react sooner or later on the fortunes of even the more favorably situated individual firms.

Such emphasis on the time repercussions of managerial policies with reference to profits brings us back to what was just said as to the organic character of price relationships. The matter was touched on back in Chapter IV (pages 20-28), where we visualized a continuing condition of "contrived, scientific, functional profits"

<sup>4</sup> We have already suggested (Chap. 4, p. 23) that the corporate form of business now prevalent tends to encourage business administrators to consider the long future of the company rather than the making of an immediate "killing."

brought to a maximum total in the long run through "that moderate interpretation of unit profits in the single instance that promotes continuous harvesting over the years."

If the managers of modern industrial and distributive business are concerned about maximum returns from a somewhat permanent stream of transactions, they cannot with impunity follow the simple rule "charge all the traffic [at the moment] will bear" when they sell and exert all their strength as large buyers to depress the prices at which they buy. They must in their own ultimate interest assume some responsibility for the future economic situations in which they must continue to buy or in which they desire to sell. Industrial managers today have mastered the lessons learned by the early factory owners as to the need to keep wages up to a high efficiency level (Chapter IX, page 12). Many of them are also conscious of the fact that the major source of general purchasing power is the nation's payroll and that there must be equilibration between it and the market volume of goods at the prices at which they are offered (Chapter IX, pages 13 ff.). They may consider also the mutual adjustment between the rate at which labor-saving machinery is introduced and the absorption of displaced workers as conditioned by the prices being charged for products under the new technique and the "elasticity of demand" for these and other goods.<sup>5</sup>

<sup>5</sup> Whether any of the research techniques available to us could show it or not, it seems likely that labor-saving machines have been introduced faster than their economic consequences could be assimilated into the total price structure in the light of the understanding of these relationships which price makers as a whole have had. While the remedy for this situation is not to be found in Mr. Ghandi's gospel of the spinning wheel, it is probably true that American industry would, on balance, have done better with a somewhat slower introduction of such technological improvements when unaccompanied by a sufficiently courageous policy of price reduction.

If businessmen neglect these adjustments, they may still go on technically maximizing returns to their companies in each successive current transaction and yet be contributing to the creation of a general demand and cost situation which puts those maxima lower than they might otherwise be. It is a very difficult task, however, to translate these general economic relationships into a price-and-production policy and specific procedures for the product or products of the individual company. Even the business administrator who sees that the old trading maxim "buy cheap and sell dear" is glaringly inadequate to the needs of modern industrial management does not readily find a new criterion to take its place.

In seeking to determine the rate of profit on invested capital which will lead to the largest total of profits over a period as long as he thinks it practical to plan for, the business manager must consider the effect that his attempt to maintain a stipulated rate of profit will have on the general business situation or what would happen if every company followed his course. If the firm's profit is currently disbursed to the owners and promptly spent by them on consumption goods, or is promptly put back into active investments, not hoarded funds or unused plant, the flow from production to purchasing power and back to new production is maintained at full tide. But on the other hand, the rate of profits made for owners may prove so high that (in view of the concentration of ownership)<sup>6</sup> they cannot spend it all on per-

<sup>6</sup> If all capital were owned by workers in the same ratios that individual wages and salaries bear to each other, it would be a matter of indifference whether business revenues went to higher profits or to higher (percentage) labor incomes. If capital ownership were equal per capita, higher profits (fully distributed) would be the equivalent of consumer gains. In either case, however, there would still be the question whether the effect that a high-profits policy would have in raising the general price level might not be bad.

sonal consumption and yet do not promptly find investment outlets in which it will be immediately converted into productive goods or so invested or plowed back into their own company, it may fail to be fully employed. Then the labor that went into the production of that capital, instead of multiplying future real incomes, is withdrawn from even current consumption. Since the hoarded funds or the redundant plant in which profits were invested produce no return, the actual income on capital proves to be less than the ostensible rate. And it becomes evident then that current profits on active investments were above the level that could in these circumstances be maintained for the available supply.

Let us suppose that the managers of business, perceiving that such are indeed the working requirements of a system of private capitalism, decide to accept a lower rate of net return, reflecting the average of actual returns on active capital goods, idle capital goods, and hoarded funds taken together. It might occur to them that such a rate is a better measure of what capital is in fact currently capable of earning. If they then revised their price and volume practices accordingly, a workable adjustment or a valid criterion of policy would be in the process of appearing. This rewriting of the rate of profits without changing the formal criterion—maximum profits—may take any one of several forms, or may simultaneously result in adjustments in several directions.

First, those who have held funds in idleness because they thought profits should be higher than what current investments offer may release their funds into new building or expanded operations. Second, operating companies may decide to abate their program of internal saving, accept a lower profit margin, pay higher wages

or material prices (or buy more material or hire more labor at existing rates), or lower the market price of their own product. In varying degrees (according to the respective responsiveness of the different markets and areas of enterprise) these attempts from several lines of approach to put the criterion of long-time maximum returns to available capital into operative application will bring realism or workability into the price structure.

### MAINTAINING AND ENLARGING ASSET VALUES

There is, however, in the traditional thinking of both businessmen and economists a fundamental dogma that stands in the way of any prompt, decisive, and confident application of such a pragmatic criterion. This is the belief that the rate of profits to the owners must be high enough to maintain existing book values, high enough to attract new capital into the given industry or into business in general.<sup>7</sup> Asset values, once entered on the company's books either because of past profit experience or as an expression of future hope of profit, condition subsequent pricing policy, sometimes very

<sup>7</sup> While we often speak of the profits of a company as a matter of receipts exceeding expenses during a year or other period, this is a very inadequate form of statement. In the language of accounting (and that is, of course, the idiom in which the businessman thinks) profits means the amount by which the value of the company's net assets at the end of a period exceeds the value of its net assets at the beginning. This, however, involves us in the whole question of property values based both on the productivity of uses in which they are employed and on the theoretical interest rates at which these earning properties are capitalized. The intricacies of those interrelationships are affected also by monetary influences, or what is loosely referred to as the general price level. Both phenomena involve psychological elements that are separate from technical productivity but likely to confuse business policy with short-run speculative trading vicissitudes of the market. One of the outstanding manifestations of this danger is found in the appearance of inventory profits and losses which, if not carefully segregated from operative profits, plainly labelled and kept out of or made definitely subordinate to manufacturing profits, may seriously distort the management of an industrial company.

strongly. The philosophy that these valuations must be defended, however high, and if possible enhanced still further, operates, as a criterion of business policy, toward the maintenance of wide profit margins per unit of output or a high rate of profits in the next quarter or year.

If it appears that, with prospective demand, such margin or rate of profit would not be maintained, then a common practice has been to try to protect the asset value by withholding productive properties from full utilization. Restriction of supply is relied upon as the means of supporting price on a scarcity level, thereby preventing the "impairment" of asset values.<sup>8</sup> The ultimate result of such a procedure is to create unemploy-

<sup>8</sup> A highly orthodox statement of business thinking has been supplied by a prominent steel executive, then president of the Iron and Steel Institute, who advised:

"You must charge a price, under any given condition, which covers all of your costs—including the cost of carrying unused capacity—and returns a reasonable profit. If you fail to charge such a price, you must give something away. And in business, if you continue to give something away for very long, you eventually give the business away. No one is justified in asking business to do this. . . . Management has not been profit-minded. Instead, it has attempted to conduct business on a basis of losing as little as possible. It has resorted to dodges and stratagems . . . such as deliberate acceptance of unprofitable business in the hope that the increased volume will cut overhead costs enough to make it possible to break even or escape with a small loss while holding an old customer or getting a new one. It has justified acceptance of business at a loss on the theory that this unprofitable business would pay in the long run by helping to maintain plant, equipment and personnel. No such attempts to rationalize acceptance of business at a loss can be right. Losing business remains losing business. It produces a loss in the first instance and, human nature being what it is, when one producer gives an unwarranted price, competitors meet competition. The result is that the concession sets a new industry-wide price still farther below the level of profits and even of costs. . . . Management, which after all is hired by the stockholders to make profits, has failed in its principal duty." Ernest T. Weir, "Profits and Patriotism," address before the American Institute of Steel Construction, New York, Oct. 17, 1939.

This quotation must of course be read in the context of the speaker's own business record. He has been known in the steel industry as a "price cutter."



ment, which restricts the market and thus impairs even the earning power which had already been found inadequate to support previous asset valuations. The more stubborn the insistence on book values of assets, the more the tendency to make business break instead of bending to the force of an actual business situation.<sup>9</sup>

When "assets are impaired," a company is on the road to "failure" and this is often spoken of as synonymous with disappearance from the business scene, and this in turn as meaning that jobs will be destroyed and the serving of consumers' wants curtailed. It is accordingly argued that returns to capital must be kept high enough so that asset values shall be maintained and if possible kept growing. As a matter of fact, however, disastrous economic consequences do not necessarily follow from impairment of asset values. We have talked so much about "ease of entry" that we sometimes fail to give sufficient emphasis to the difficulty of exit of firms from the modern industrial scene.

It has long been remarked that a great railroad system

<sup>9</sup> A fundamental difficulty which men encounter in attempting to run a capitalistic system lies in their failure to appreciate the evanescent character of wealth embodied in physical properties and the indispensability of sustained authorization of labor use to the preservation of even funded wealth. It was a great merit of Adam Smith that he definitely turned from the idea of wealth as an accumulated stock to whose conservation society was devoted to the more flexible and living concept of wealth as an annual flow to be stimulated, conditioned, and guided on its living course. In the first two sentences of the *Wealth of Nations*, we read: "The annual labor of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes . . . according therefore as this produce or what is purchased with it from other nations bears a greater or smaller proportion to the number of those who are to consume it, the nation will be better or worse supplied with all the necessaries and conveniences for which it has occasion." From Smith's day to the present there has been a conflict between two broad factions within the field of business and economic life—the producers and the conservators, operators and curators, those who sought to enlarge economic enterprise and those who sought to maintain property valuations.

cannot go out of business. And the same can probably be said of U. S. Steel, General Motors, or du Pont. Failure does not bring death of the business but displacement of management, corporate reorganization, or both. What has transpired is failure of the managerial policy or the corporate structure to adapt itself to internal or external requirements. Shrinkage of asset values very often does not mean that the company cannot justify its existence and serve the public at a price in excess of operating costs, including market rates of interest on the capital necessarily involved. It often means simply that artificial prices were paid for properties or artificial appraisals given to plant or equipment that the company has fabricated for its own use. It may mean that good will, patents, or other franchise values, disclosed or disguised, have built up an inflated capital structure in the days of promotional development or of abnormally high earnings in short-run periods of general boom-time psychology or the initial market spurt of a new and popular product.

In such situations, putting the company "through the wringer," adjusting its asset valuations to the profit margin on which it can continuously and fully utilize its resources,<sup>10</sup> has so frequently shown its healing effects

<sup>10</sup> This reorganization of capital structure when accompanied by a change in managerial personnel constitutes an important qualification to the oft-repeated assertion that an enterpriser must make enough profits to keep him in business if the community is to be served. It may be necessary for him to yield management to other hands if the resources which he has formerly been directing are to be able to deliver their productive contribution in fullest measure.

Besides reorganization of a company under its own name or with at least a continued separate corporate personality, the revision of corporate assets may be accompanied by merger into some other company or companies. But even when there is complete liquidation of the old company, its separate plants or other facilities may be sold outright and thereby revalued on a more workable basis. Finally, even dismantling of plant and sale of separate assets does not mean that the economy suffers

that it seems strange that revaluation is not more readily accepted as the indicated remedy for local business ailments and as a preventive measure against more widespread and persistent economic ills.

Subtly intertwined with this question of accounting valuation of assets, tangible and intangible, is the issue of how much capital society needs and at what rate it should be accumulated. It is often argued that asset values must be maintained or advanced and the rate of profits to which they are related kept as high as possible so as always to encourage the formation of new capital. Everyone would agree no doubt that it is desirable for the productiveness of the economy that we keep enlarging our supply of aids to labor at as rapid a rate as those implements will be actually used in production.<sup>11</sup> But to pile up capital goods or funds in excess of such use means that capital ceases to provide employment or increase productivity and becomes a cause of unemploy-

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a capital loss equal to the devaluation. The relatively high valuation of an earlier period may have served a useful purpose at the time by giving a profit to the enterprise which produced the goods, and this profit may have had a beneficial effect on the economy by giving a desirable stimulus to business at that time. On the other hand, such stimulus may have contributed to the over-expansion of the firm which enjoyed it or to the generally overstimulated atmosphere of a boom period. Paying so high a price for equipment may have been a factor in the subsequent failure of the purchasing company, whereas its sale in the market now may be a necessary procedure for having it revalued and passed into the hands of a new company on a basis on which it can be actively committed to further production.

<sup>11</sup> This is of course an oversimplified statement because capital goods may be used with widely varying degrees of intensiveness and the degree of intensiveness which is to be regarded as economically justifiable as the criterion for its creation or preservation will vary according to a large number of price relationships. Some of these are themselves in part determined by the amount of the capital goods accumulation and manner of its use. The "fullness of use" criterion therefore will have to be determined on the ascertained (comparative) merits of each case.

ment. "Capitalism the creator"<sup>12</sup> is distorted into capitalism the waster.

The exigencies of war have, in the last few years, called forth an almost fabulous outpouring of capital, both private and public, in the creation of additional plant. While it is hazardous to attempt to appraise the productive capacity of this plant after re-conversion to peacetime needs, it seems probable that capital shortage will be much less of a threat to national prosperity than possible labor disuse. First concern should be given to providing such a disbursement of purchasing power as will assure taking promptly from the market all the goods that the whole labor supply can produce with a plant of its then size and degree of efficiency. Once that

<sup>12</sup> In a book under this title, Carl Snyder has put forth in stark simplicity the favorable aspects of the case for unlimited capital formation.

Such an economic philosophy (or religion of wealth) reduces capital goods and capital funds to the role of "sacred cows," worshipfully tended by a people suffering from deficiencies of both meat and milk. A release from this Brahman psychology among our stupid cousins overseas would not result in the disappearance of the bovine population but in its growth in numbers, in service, and in public esteem. Nor would release from a Brahman economic psychology among our not too perspicacious selves lead to the death or decay of capital but to its propagation on more scientific principles, with a larger steady flow of current product and substantial enjoyment from the incidental liquidation of such units as, brought into being in the normal technique of operation, proved to be "surplus" from the point of view of its most economical continuance.

It is interesting to speculate on possible results if those who set for themselves the criterion of maximizing asset values were to revise this to read "minimizing asset values," that is, holding the overhead for capital as low as could be done without leaving labor short of equipment. Recent experience with unemployment suggests that any possible danger of lowered "qualitative efficiency" which might be incurred by setting their profit sights too low would be considerably less than the losses in "quantitative efficiency" with which we are all too familiar as a result of setting their sights too high. Saving is not something which is a good in itself but rather a necessary evil, since it means that the fruits of labor cannot be currently enjoyed. Society, like the individual, wants to save as little as is necessary to the maintenance of a given state of real income.

is done, we shall find that the problem of capital accumulation, in the interest of supplying the economy with yet larger or more efficient plant, presents no real difficulty under conditions of full-scale operation and the business confidence which full operation engenders.

To state the case thus brings to the fore one aspect of the whole capitalistic process in a credit economy which is frequently overlooked and which has been held in abeyance throughout the preceding parts of this chapter. That is the fact that capital is formed through the current operations of an industrial system and does not have to be accumulated in full before the beginning of the operative period. What is required is not alone that owners of plant or money savings (or their deputies) shall have enterprise but also that credit agencies (with sufficient proportion of reserves) shall be convinced that the operations of a given enterprise will prove self-liquidating if undertaken.

More and more in recent years, a consideration that has operated to withhold the "go" signal from those who would offer jobs has been the uncertainty as to whether other executives would have the confidence to go ahead. Technical and commercial risks can be held to a minimum through the employment of specially skilled personnel. The inescapable remainder can be calculated on fairly dependable actuarial principles and charged as a necessary operating cost. But if the executive sees a strong prospect of substantial unemployment or non-utilization of plant capacity, and if he writes this prospect into his cost sheets and consumer prices and it is reflected in the withholding rates for capital use or industrial credit extension, then business stagnation becomes inevitable. Only its degree remains to be determined by the extent to which businessmen take into

their calculations the possibility of such unpropitious developments. The higher they rate such probability, the more is it converted to a certainty—the certainty of business depression, becoming chronic as stagnation.

This paradox of our profit-making system of private capitalism will be examined presently in a concrete setting. But first we need to consider briefly the outlook from which business policy is determined today.

#### **FROM PATER FAMILIAS TO THE PROFESSIONAL MANAGER**

In an earlier chapter we noted that “no particular problem as to the meaning of profits or the operation of the profit motive arises so long as business is conducted on the basis of individual enterprise”<sup>13</sup> or pre-capitalism. The individual was self-employed or, more accurately, business was organized on the basis of the family’s unpaid labor. The pure case would be that in which the only capital employed consisted of such productive goods as were accumulated from the labor of the family in rearing livestock and fashioning simple devices and appliances or in which such equipment was secured in trade for some of the family’s produce.

There was, under such circumstances, no separate capital account or distinguishable income-to-capital. Nor was there any possibility of increasing gains to anyone by withholding productive labor or the use of such equipment. On the contrary, the more labor input, the more subsistence for the workers. Effort would be diverted from consumption goods to the making of machines or other labor aids when that course promised more than proportionate returns in the future, and these would, without undue hesitation, be reabsorbed into the stream of consumption whenever that seemed expedient

<sup>13</sup> Chap. 4, p. 1.

in view of a changed situation or scale of relative values. The essential point of the relationship was that labor use was paramount, and capital existed only for the purpose of making that labor more productive.

At the opposite pole, under any fully developed fascist, communist, or even socialist régime, the use of labor would again be the prime consideration and capital would again be merely ancillary. The provident state would take the place of *pater familias*—or of a majority of the *patres familiarum*. It would take responsibility for putting the whole labor force to work and for allocating workers' efforts to the production of consumers' goods and the provision of capital equipment in suitable proportions. A capital account might or might not be kept. But relative indifference to the fate of particular valuations of capital goods or the maintenance of high earnings to individual bits of the capital fund would take the place of the considerable indifference that private capitalism manifests as to the income position of the individual laborer in general or as to the utilization of the whole labor force at high efficiency.<sup>14</sup>

Between these two extremes, with their reliance respectively on automatic and on authoritarian price making, private capitalism relies largely on administered price making by professional managers to adjust consumer prices, contract wages, profit margins, wage and salary bonuses and profit-sharing distributions. We expect these adjustments to be such as to attain a high level of performance for the economy, that is, high real incomes for its several participants, based upon full utilization as well as proper allocation of the nation's resources.

<sup>14</sup> That an autarchic economic organization also has its own distinctive problems and dangers is obvious, but they are no part of our present analysis.

These managers of business corporations large and small who make up the determinative center of modern business<sup>15</sup> may be classed as part of the labor group in that their remuneration is primarily on the basis of a contract wage. But this group is also identified directly with the ownership group through the investment of its own money in shares of the company, through receiving such shares as partial payment for its services, and through bonuses whose amount is contingent on the profits made by the company. It has, however, a distinctive character in that its role is that of professional administration. It thus might be expected to have a somewhat objective concern for promoting the welfare of all the intermingled special interests. It has been customary to refer to professional management as trustee for the owners. It is perhaps truer or would be more helpful in future to think of professional managers as trustees for the economy, their objective being to cause the individual company to function with the highest degree of economic efficiency as an interrelated part of the total business process.

Let us now suppose that the corporate executive were to write his business policies without duress (from organized labor, government bureaus, or credit suppliers) but with all the economic sophistication proper to a trustee for the economy. He then might say: Workers,

<sup>15</sup> There is, to be sure, a measure of control or influence still exercised by owners of proprietary capital as such. There is some participation in policy making by financial interests, who represent loan capital as well as proprietary capital. There is a considerable "intrusion" of governmental influence or regulatory control in matters of policy. Finally, labor unions have become a substantial factor in influencing, determining, or warping policy. Consideration of the role of government will be deferred to a later chapter. The part played by organized labor and by financial interests is touched upon at various places in this and other chapters. But this book is focused primarily on what industrial executives do or might do voluntarily within their own province of control.



both those in overalls and those in white collars, must, so far as our resources and techniques permit, be given a wage that will provide good food, clothing, and housing; education and amusement; adequate care of health and provision for old age. To safeguard their long-time interest I, as manager, must see that the proportion of total labor time that goes to capital maintenance or of total product that goes to remunerate those who provide capital is adequate to keep up technical efficiency and gradually advance it. Since the only economic reason for the existence of capital is to add to labor productivity, if my scheme of management makes good the attrition of capital and strikes a sound balance between currently maintaining the personal or internal efficiency of workers and equipping them with the external techniques and appliances of efficiency, I shall have secured for capital its maximum realizable long-run gain as a necessary accompaniment to securing maximum labor returns to the worker.

To provide such returns to all the accumulated capital now seeking employment, managers as a whole must first recruit all available workers. If further supplies of funds are required for such full-scale operation, premiums above the interest rate of the general money market may perhaps be required during periods of initial development and market proving. But if such rates are exacted for operations which are in fact routine, the resulting price adjustment becomes merely inflationary under decentralized ownership of capital or disruptive (leading to chronic underemployment) under the present pattern of concentrated ownership.

Such a professional manager would have been convinced by study of economic principles, by scrutiny of business experience, or by a fruitful combination of both

that the attempt to enlarge asset values and then defend them by maximizing profit margins or rates through restraint of production leads to underutilization of resources and progressive unemployment.<sup>16</sup> He would have decided that for an economy to operate successfully on the basis of private capitalistic enterprise, the necessary sequence of consideration must be from maximum productivity to full labor opportunity, thence to steady use of capital at its necessary supply price, thence to high real wages, that is, maximum satisfaction for the consuming masses.

This would be equivalent to saying that even in a capitalist economy the attainment of maximum profits or asset values for owners cannot be taken as a proximate end of current operations. It is one ultimate objective of a complex economic process. Since natural resources and man's machines reach their highest earning power only when fully manned, the *criterion of action* or of operative *policy* by which profit maximization is to be *approached* must be full employment of the labor resource.<sup>17</sup> Such a restatement of the criterion of capitalistic

<sup>16</sup> At many places in this book reference has been made to the fact that the official of organized labor has become so important a factor in the determination of price relations as to complicate if not defeat the program that the professional manager might draft in accordance with the general policy and economic philosophy here outlined. Thus far, labor has not been able, nor has it really desired, to take responsibility for the operation of the system. But in so far as it becomes cognizant of the results of its own exercise of power it would have to adopt this same criterion of full employment as superior to its customary exacting of the highest rate that can be secured by the exercise of its control of supply. At the same time it would have to assume the responsibility of making provision for capital sufficient to maintain its supply (including expansion and the research facilities on which progressive technique is based) and afford it incentive for active use.

<sup>17</sup> Full employment is a loose phrase which may be defined either functionally or quantitatively. Earlier in this book it has at several places been referred to functionally as meaning giving all potential workers opportunity of employment up to the point at which they

management may at first sound seem revolutionary. But the only sense in which it challenges conventional economic and business thinking is in its rejection of the tenet of capitalistic fundamentalism<sup>19</sup>—that capital has some mystic superiority over other factors of production as a claimant to returns or as it challenges a belief that such priority can be granted without upsetting the balance of economic forces.

But even when the basic character of the employment criterion of business policy is realized, we are still faced with the practical question of how such a criterion can be applied. Private capitalism, as we have known it, has advanced from a condition of no responsibility for maintaining the quality of the labor supply or for seeing that it is productively used to a point where it accepts considerable responsibility for the workers specifically attached to a given firm or (to some extent) to an industry. But if private capitalism is not to destroy itself through the reduction of the economy's total productivity, through unemployment and low utilization of capital goods and funds, it must find a way of exercising joint responsibility for providing employment opportunities for the whole available labor force. Professional managers are, by virtue of their administrative position, responsible for conserving labor opportunities for the whole population. This they can do with greater skill than was available to the heads of individual family

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value leisure more highly than further goods or services that could be purchased with their wages. Quantitatively, there seems to be pretty general agreement that an industrial country is not likely to be able to apply more than 95 per cent of its nominal labor force even under the most favorable circumstances. This would mean a "float" of some 3 million or more in this country, not working even when we had so-called full employment.

<sup>19</sup> With apologies to Joseph S. Davis and his suggestive critique of "agricultural fundamentalism." See *On Agricultural Policy*, Chap. 2.

groups and with greater intimacy of knowledge and flexibility of direction than central control can achieve. Only recently have they begun to admit this responsibility and to devise means of meeting it.

#### FULL EMPLOYMENT AS MANAGEMENT'S CRITERION

Up to the present time, almost everyone has been disposed to feel that, if a criterion of full employment were to be applied, it would have to be by the economy as a whole, that is by government under a scheme of comprehensive economic planning. Such a criterion has been regarded as purely irrelevant for the individual firm. It has not appeared practically possible for these firms to set up individual employment quotas or to accept or assume responsibility for any particular labor force as did *pater familias* under simple schemes of economic organization or as government does in Fascist countries or would do under a planned economy in the United States.

But today, practical businessmen are themselves informing the public that they do accept such a criterion of operation and that they propose to put it into effect at the close of the war. Most clear-cut in such declarations are the General Electric Company and the Aluminum Company of America.<sup>19</sup> Pronouncements by these

<sup>19</sup> To this general effect also, the American Rolling Mill Co. expresses itself in a display advertisement in the *Saturday Evening Post* of Apr. 10, 1943. The major part of the text of that advertisement reads as follows: "Will [your boy] come home [from the war] to a normal life—a useful job? That is a question none of us can ignore. Even now, while all the production of the nation is bent upon victory, farsighted men in American industry are planning ahead. There must be no let-down after this war. Industry is preparing now to convert quickly for the manufacture of peacetime products to give jobs to the millions of men now fighting and the other millions of war workers.

"This war has *telescoped* time in improving materials and methods. Here at ARMCO, for instance, our laboratories and mills are developing sheet steels with extraordinary new properties and constantly improving

AMERICANS LOOK AHEAD. . . . They see that jobs for all are the first essential to a peaceful peace. . . . The number of men you can keep on your pay roll; and the number of new ones you can add to your payroll, when this thing is over, is the real measure of how good a peace we have won. . . . There are millions of new jobs to be made when this war is over. They are your responsibility and ours.

As we see it, the only thing that will keep men employed then is a large dose of *Imaginering* right now. . . . We coined the word to describe the audacious imagination, plus action, which is needed to outwit the future. . . . The word pins down the thought that it is the individual executive, daring to let his imagination soar, and then engineering it down to earth—it is you doing just that to your business, who will win the peace for yourself, and for America. . . . It's a kind of flame lighting America to its future. Alcoa Aluminum is one fuel to make the flame burn brightly.

Start with the bald facts that what America must have when this is over is a low price structure, new things to make and use; new services to render, new ways to make and do old things. Match the new low prices of aluminum, the new techniques, the new alloys and the old fundamentals of light weight and all the rest, against what you yourself face, and what America needs, and you have found the groove to let your *Imaginering* run in.

Two can run better than one in that groove. We have the old-fashioned idea that if we can help you look at your work audaciously in terms of the product we make, that teamwork will help us both employ more men at a time when America is going to need employment.

Advertisements of Aluminum Company of America, January-April 1942.

two companies are set forth on pages 24, 26, and 28. Such declarations, however, even if sound in principle, have yet to be carried into practice. Have these companies perfected a procedure for achieving the objectives set, for applying the criterion announced?

ALCOA says, in general terms, that this means "mixing engineering with imagination." This might well mean combining technological skill with economic insights into the way in which money relationships have to be adjusted if business is to operate at full volume. It might mean having the imagination to see how the peacetime use of aluminum could be expanded to the fantastic proportions of wartime and still preserve the solvency of the company. To such an interpretation of ALCOA's phrases we shall return presently.

Meanwhile, we must examine the somewhat more specific outline of criteria and methods that has been proposed by G.E. Mr. Wilson former president of the company, who first outlined the policy, is an outstanding "production man," and Vice President Prince to whom its execution has been specifically delegated is a distinguished engineer (past president of the American Institute of Electrical Engineers). Hence it is not strange that one plank of their platform should call for engineering determinations of the technical specifications of the products which are to make up the volume of output necessary to discharge their responsibility for continuing their wartime labor force in peacetime employment. But besides committing themselves to showing the techno-

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the older ones. After the war, manufacturers will have many new steels for making lighter, stronger, and more attractive products.

"Every time you buy a War Bond you are helping to speed the day when our boys come home. You will have the savings to buy some of the new and better things you will need, and this will help provide jobs that our boys can do with enthusiasm and skill."

AT THIS TIME, when our future economic security is at stake, we must call upon all of our vision and imagination—upon all of our resources—upon all of our ingenuity—and, above all, upon the same deep sense of service that now motivates us . . . in providing the materials for our physical security—to the end that all employables will be kept employed—and that the preponderant majority will find employment on the payrolls of the private enterprise system.

Charles E. Wilson, address, American Institute of Electrical Engineers, Jan. 29, 1941.

IF, WHEN THE END COMES, we have made no plans for the postwar period, we may lose all the fruits of victory. We must, therefore, be prepared to take advantage of our victory when it comes and begin to think now about the future. . . .

There are good reasons for expecting an era of full employment after the war. Extensive plans are being made for the government by members of the National Resources Planning Board—plans for public works projects which they propose to throw into the pot if unemployment begins to appear. Therefore the question is not whether or not we shall have full employment but what *kind* of employment we shall have.

We shall start with the assumption that there will be full employment which will yield 110 billions of dollars' worth of production, and then we shall see what the electrical manufacturing component of that total amounts to. We estimate that some 3 billion, 849 million dollars, more or less, will cover the electrical manufacturers' component but that part of that component will represent items that the General Electric Company does not happen to make. Then we will get down to the things of which the parent General Electric Company does produce a part. If we have esti-

*Continued on page 28*

logical imagination necessary to make this system work, G.E. gives a pencil sketch, even if somewhat shadowy, of the economic mechanism by which they expect to see the policy carried to successful execution. The salient features of the G.E. analysis may be set forth in a single paragraph.

Starting from the assumption that 110 billion dollars of purchasing power *will be maintained* in the market,<sup>20</sup> they define the commercial side of their task merely as keeping in touch with the trend of consumer demand so as to know with reasonable accuracy the types of expenditure among which the public will apportion that amount of spending money. Then the company plans to allocate the proper amount of the productive resources under its administration to the lines of manufacture thus nominated. As to the fundamental economic process by which this flow of purchasing power is to be continuously forthcoming, Mr. Prince in the first part of his statement pins his faith to the fact that "extensive plans are being made for the government by members of the National Resources Planning Board . . . for public works projects to throw into the pot if unemployment begins to appear."

With the engineering and commercial plank in this platform we are in complete accord. If private business is to operate successfully in the future, one of the two major functions that the professional management of those private enterprises must perform is that of select-

<sup>20</sup> In the light of subsequent events, Mr. Prince revised this figure upward. Addressing the National Retail Dry Goods Association recently, he "estimated that two years after the war 57,000,000 people would produce, on a forty-hour-week basis, a total output with a value of \$135,000,000,000." (*New York Times*, Jan. 15, 1943, p. 30.) In view of uncertainty about the future price level or the course of inflation, no dollar figure can have any significance. What is really meant is simply a full-operation national income.



mates of the national market for those things and if we know also the percentage of the business which we can normally count on getting, we can construct a budget of probable business in the different departments of the General Electric Company. Then, when we match that business against our capacity and our personnel, we shall obtain a figure which represents the number of workers we shall need after the war. And the point is that some of the people now employed will be left over.

However, some of those people will not wish to continue with General Electric. . . . But there will be some people in that group who were unemployed before, or maybe some of them will be youngsters just out of school, and they are the ones we shall wish to keep employed—the ones we shall have to keep employed if the country as a whole is to enjoy full employment. If we do not find work for them and if other companies in the same position do not find work for their excess personnel, unemployment will become a problem again. That means that the country will not reach the 110-billion-dollar output figure and that, in turn, the electrical component will be smaller than we have estimated and our share smaller. Then we shall find ourselves with an even larger group of excess employees. Thus the best thing to do is just to assume that we must find jobs for all the people left on our hands. We owe it both to them and to the country to do our best to provide for them. . . .

If we were to be alone, the whole thing would fall of its own weight. I am very confident, however, that this same kind of thinking is going on in many industries all over the country. I know of a good many specific cases; also . . . certain areas in which industrial managements are thinking about the problem as it affects entire communities.

David C. Prince, address, American Management Association, Mar. 4, 1942.

ing the types of goods to be offered in the consumer market, simplifying and perfecting the technological (including artistic) character of these goods or devising new ones, and keeping closely in touch with the behavior of the public in apportioning its purchasing power among these different goods and responding to such "consumer appeal" as private enterprisers succeed in embodying in their products. There is every reason for the American public to have confidence that the engineering staffs of G.E., ALCOA, or almost any other of our well-established industrial corporations will give highly skilful, soundly progressive, richly "imaginative" treatment to these problems. Detailed blueprints of such developments are accumulating in their research files. They use some of their advertising space every now and again to give the public a peep into those files and to whet consumer appetites for the postwar market.

But the second major function of management is to perfect a scheme of disbursements that will bring the cost structure, the price structure, and the income structure of the economy into continuous working balance. The prospect that businessmen will see how to do this after the war seems much less reassuring than that technical and operative problems will be well met. The economic plank in the G.E. platform is at best ambiguous. It starts out by saying: "We will count on Uncle Sam to maintain purchasing power. This is not our concern." There is no intimation that the General Electric Company, the Aluminum Company of America, General Motors, du Pont, U. S. Steel, and the rest would themselves need to assume or accept responsibility for disbursing the purchasing power necessary to take off the market the whole product turned out by a fully employed people. It would seem that Mr. Prince is

ready to join the large and, one fears, growing ranks of those who are ready to rely on continual transfusions from the public Treasury to keep "private" business alive.

Another Brookings publication<sup>21</sup> has shown various limitations and dangers which beset this simple faith in the capacity of the "provident state" to inject perennial streams of supplementary purchasing power into the economic system from some miraculous and inexhaustible source. The reader may be referred to that publication for detailed analysis of the fiscal aspects of the public spending philosophy. But a few points need to be noted here very briefly to bring the proposal of government provision of purchasing power into perspective with the price-making process and the productive realities of our business world.

#### RELIANCE ON GOVERNMENT *VERSUS* SELF-SUSTAINING BUSINESS ADMINISTRATION

Public spending as a remedy for the disease of unemployment or as a safeguard against the threat of economic stagnation presents a psychological dilemma to the business world. There are many businessmen to whom the government's promise of employment opportunities to all through public spending constitutes a threat of national insolvency, inflation, confiscatory taxation, and everything which makes private business impossible. To others it seems a guarantee of sustained markets which make business commitments safe.

If the first of these views prevails, every step that government takes in accepting or asserting responsibility for the productive operation of the economic system causes private enterprise and private capital to withdraw

<sup>21</sup> Harold G. Moulton, *The New Philosophy of Public Debt* (1943).

in uncertainty and fear by one or two steps or even ten steps. It then becomes but a short road to state socialism, complete regimentation of business activity. This psychology has been fully expounded by conservative business leaders time and again over the last decade, and the "disappointing recovery" of 1937 suggested that such an ultimate sequence might be in the process of completion when suddenly the war introduced a powerful external stimulus.

The statement of the General Electric Company, however, displays a quite different psychology as to the postwar effort. This spokesman for business turns confidently toward the other horn of the dilemma—albeit with serious ambiguity as to how self-dependent business is to find a practical solution to its purchasing power problem. Looking to government as an ultimate safeguard to the maintenance of national income does not obscure a sense of responsibility on behalf of his company for the supplying of employment. Near the close of his statement (page 28) he says:

If we do not find work for [all our wartime employees who want to stay with us after the war] and if other companies in the same position do not find work for their excess personnel . . . the country will not reach the 110 billion dollar output figure and . . . our share will be smaller than we have estimated. Then we shall find ourselves with an even larger group of excess employees. *Thus the best thing to do is just to assume that we must find jobs for all the people left on our hands.*

The sentence which we have italicized proposes a policy or rule of action for the individual firm. This proposal is followed a little later by an admission that such an assumption of responsibility for creating private employment would be futile if any individual company undertook it alone. But that admission is in turn followed

by an expression of great confidence "that this same kind of thinking is going on in many industries all over the country . . . areas in which industrial managements are thinking about the problem as it affects entire communities."

So far, so good. If every other employer were to meet the postwar situation with confidence and act with his best managerial skill to allocate men and plant to the supplying of a full-employment budget of consumer wants, the tide of national economic life would set strongly toward reconversion to peacetime operation on a scale of activity equal to the war peak and doubtless better than 1928-29. This would not completely solve the problem, but it would deal with one factor indispensable to the solution of the problem. It would remove or greatly reduce the responsibility of the government to make jobs for the unemployed, thus facilitating balancing of the federal budget, with such gradual curtailment of the national debt as might seem most beneficial to the general economic situation. An initial psychological reaction of self-confidence would promote a situation in which private enterprise could move more freely into active investment, and credit would be extended through customary financing agencies so freely that there would be a minimum possibility of plant remaining idle for lack of working capital or of workers failing to find private employment.

But if the technique of price relations on which private business starts its peacetime operations is faulty, a new market breakdown will develop sooner or later. To this lack in the program even of those who are urging private business to go aggressively forward, we shall return presently. (See pages 38 ff.)

Concrete evidence that the view that the individual

employer "must find jobs for all the people left on our hands" has spread, and that organized effort will be directed toward making it a tangible force in the postwar business world is afforded by the recently formed Committee for Economic Development. Through this body the movement "to promote company-by-company planning for postwar opportunities . . . jobs and the production in private enterprise which can create jobs"<sup>22</sup> may now be regarded as organized and systematized on a national scale. Mr. Prince has become chairman of its industrial advisory board and it has set up a Field Development Division with twelve regional and about 100 district boards. These boards undertake to stimulate and assist small as well as large companies in deciding on types of products to turn out after the war, scale of operations for each, markets available and best means of developing them, and other operative problems of the reconversion period.

All this is simply an elaboration of the sound and important methods of attack outlined in Mr. Prince's original statement. In carrying it out, the Committee for Economic Development draws upon the factual and analytical work of the United States Department of Commerce<sup>23</sup> as well as the technical and managerial staffs of all the many companies who are being interested in the movement. To this it adds a research advisory committee and staff of its own.

<sup>22</sup> *C. E. D. News*, May 1943, p. 1.

<sup>23</sup> The Committee emphasizes the point that it is an entirely independent non-governmental agency, formulating its own policies and program, recruiting its own personnel, and supplying its own working funds. It maintains a Washington liaison office in the Bureau of Foreign and Domestic Commerce, however, which enables it to have fullest knowledge of and readiest access to unpublished as well as published materials of the Bureau and enables the latter to shape its current studies so as to be of maximum usefulness in the Committee's work. See for

It is only natural that thus far there should be little to indicate the more fundamental economic philosophy of the movement. That is yet to emerge from further study of the problem by staff, advisers, and participants. As to the orientation and probable impact of the Committee's work, its chairman, Paul Hoffman, president of the Studebaker Corporation, addressing the Union League Club in Chicago on March 12, 1943, said: "We have got to have a rip-roaring, hell-raising, risk-taking economy. We feel that if a million American enterprisers get into action now, the 130 million Americans will be able to plan their own lives after the war." But he immediately introduced a note of ambiguity by saying: "No matter how much of an effort we make, we cannot succeed unless the political climate after the war is favorable." If this means a climate favorable to the fundamentalist claims of capital, one which would lower wages and abate taxes on business so that profits rates might be put back (after war deprivations) as high as those that determined the withholding rates of capital before the war,<sup>24</sup> then we should soon be back at the business stagnation and high unemployment that gripped us in the thirties.

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example the recent study of S. Morris Livingston, *Markets after the War: An Approach to their Analysis*, U. S. Department of Commerce (March 1943), proc.

<sup>24</sup> Compare pp. 11, 16, 20, 44. A bit reassuring was the speech delivered by William Benton, vice chairman of the Committee, before the Producers' Council, Inc. and the American Institute of Architects in Cincinnati on May 26, 1943. Commenting on the vast possibilities of the construction industry in the years after the war, he observed: "Practices in the [construction] industry force and keep prices up. They do not bring them down. Every form of so-called monopolistic practice seems to come to full flower in the political, labor, and business standards which prevail in your industry. . . . Many feel that every business practice which impedes employment and production must be fought. How else can business honestly go to labor or to government and say—'Give us conditions under which we can operate?'"

. . . THE GREAT MISTAKE that many organizations have made in the past has been to plan solely for themselves. . . . A program of principles and of action which may seem perfect from the vantage point of labor or management or agriculture or government—is useless unless it can stand the test of scrutiny from all other points of view. . . .

I believe that enlightened self-interest, whether in the behavior of an individual or a nation, is the most reliable basis for action. . . . But we have learned from tragic experience that the machine will go dead unless full allowances are made for competing and conflicting self-interests. We have learned that we cannot have a healthy farm or factory, or a healthy business or trade-union, unless the country as a whole is in a vigorous and healthy condition. . . .

Whatever immediate advantages any element in the population may grab, must be paid for a hundredfold ultimately in imbalance and chaos. Intelligent self-interest demands that the well-being of the whole American people be made the sole and final criterion of action. . . . America adheres resolutely to its faith in the individual and its preference for high striving and full-blooded adventure. . . .

In the field of economy, democracy has taken the form of a free capitalist society. . . . Far from being played out, free economy in our country is only getting into full stride. . . .

We have mastered the art of mass production. It now remains for us to master the art of mass distribution, so that the products of our magnificent industrial machine may be ever more widely spread among all our people. This is no longer a pious wish.

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It is a concrete necessity. We are geared for unprecedented output of the essentials of life as well as the refinements of living. . . . To absorb that tremendous output, business and labor and agriculture must cooperate to maintain full employment, high wages, and maximum purchasing power. . . .

Only the wilfully blind can fail to see that the old-style capitalism of a primitive freebooting period is gone forever. The capitalism of complete laissez-faire, which thrived on low wages and maximum profits for minimum turnover, which rejected collective bargaining and fought against justified public regulation of the competitive process, is a thing of the past. Those who would turn back the clock of history in this respect are as unrealistic in their way as the addle-brained paper planners of our economic salvation.

American economy . . . today . . . is gearing itself for low profits on a great turnover. The fair distribution of the products and the wealth flowing from the industrial process cannot be left wholly to chance, but must be made one of the essential objectives of industrial planning. American economy cannot reject responsibility for the employment and well-being of the men and women who take a part in it: those who supply the raw materials, those who do the manual labor, those who do the brain work, those who manage enterprise. It must accept this responsibility as an intrinsic part of its function.

The new capitalism, as I prefer to call it, is shedding the last traces of its nostalgic memory of unbridled individualism.

Eric A. Johnston, address, Chamber of Commerce of the United States, Apr. 27, 1943.

Meanwhile, other voices of business leadership are to be heard. Eric Johnston, president of the Chamber of Commerce of the United States, addressing its annual convention on April 27, 1943, expounded an interpretation of "the new capitalism" of "enlightened self interest [which] demands that the well-being of the whole American people be made the sole and final criterion of action" (see pages 35, 36). As to how that over-all criterion is to be translated into a rule of action for the individual executive he suggests "low profits on a great turnover." Clearly this would shift the criterion of profit-seeking management away from high margin per unit of product. Would it identify it with high rate of profit on invested capital? Or with high total profits in the long run resulting from more moderate rates currently? Here, too, the record is thus far silent, and we shall have to await future speeches of Mr. Johnston or future activities of the Chamber of Commerce.<sup>25</sup>

<sup>25</sup> The annual work program of the Chamber of Commerce of the U.S.A. approved by the Board on June 18, 1943, set up three major objectives: (1) winning the war; (2) preparing for victory; (3) long range. No mention is made under any of these heads of the issue of employment or the possible reappearance of unemployment, the means of assuring adequate postwar markets, or the problem of price relations. "As a long-range matter, the Chamber should deal boldly with issues involved in the attainment of free competitive economy, and with the preservation of representative democracy. To do so may mean fighting to maintain the status quo; it may also mean working for readjustments that will enable business to meet new conditions and new demands." The two items of the nine-point "action program" adopted by the Board which touch the problem we are discussing are as follows: "(1) Formulate a constructive program for effective price controls, without subsidies, and with minimum disruption of established business usages; (2) Formulate policies and work for Congressional action to provide now for the orderly removal of unnecessary controls in the interest of a stable transition period."

The National Association of Manufacturers has made a somewhat fuller pronouncement in the form of a 47-page pamphlet, *Jobs—Freedom—Opportunity* under date of Mar. 1, 1943. Under "Domestic Requirements for Prosperity," it speaks "in the postwar period . . . as there

It may be that a good practical strategy is being followed by the Chamber of Commerce, the Committee on Economic Development, and others in placing their emphasis so exclusively on expanding the particular enterpriser's own line of production, which runs with his natural predilections, and on furnishing jobs to all who want to work, which businessmen are coming to feel strongly as a patriotic obligation and as a prerequisite to the survival of private enterprise. It is perhaps an astute pedagogy that refrains from subjecting the mass of businessmen at this juncture to the suggestion of lower unit prices or abstemious rates of profit as means of entrenching a sustained prosperity. It might be argued that, once the flood of full production comes upon the market, active competition to move this product into consumption will effect the correct and necessary price adjustment.

Such an argument, however, must fall for two reasons—one psychological, the other administrative. If the reconversion to private peacetime operations is to

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has been in the past, strong competition between business firms, small and large, producing new products and improvements of former products, to supply more and better goods for the public. . . . The volume of business, of new investment, of physical production, and hence of employment, is dependent upon relationships between prices of goods and services which promote exchange of maximum quantities. . . . A condition of balanced price relationships conducive to a high volume of exchange of goods and services is characterized by low prices; that is, prices low in relation to existing incomes."

To all this, the present writer would be disposed to respond: "Hear! Hear!" But he is less clear as to the probable implications of what follows: "There is great danger that, following this war, efforts will be made arbitrarily to maintain price relationships existing at the war's end, instead of facilitating the adjustments that may be essential to the attainment of an equilibrium that will enable the various groups engaged in productive activities to buy each other's products with their own. Such efforts to maintain current price relationships would tend to crystallize maladjustments and distortions, restrict the markets for goods on which costs have been increased, and cause unemployment."

be made smoothly, swiftly, and effectively, it is necessary that the responsible executives of business shall understand the process of economic adjustment whose execution lies in their hands. They must take the necessary steps voluntarily, planfully, and in advance, rather than having unforeseen situations suddenly thrust upon them for such hastily improvised action as may then suggest itself or for such blind defensive reactions as might then emerge. A survey of recent business history strongly suggests that if businessmen convert to full-scale production on the tacit assumption that goods are to be moved on current or higher price levels, only to find that that volume cannot be moved at that level, we are likely to have chaotic market conditions and mounting inventories, which become the signal for protective and perhaps panicky shutdowns of plant.

Approaching the matter from the administrative side, it is evidently impracticable to re-price houses, automobiles, electric refrigerators, or even lesser branded goods as perishables are priced over the counter from day to day. Under administered price making, the executive must see the whole process of cost-incurring production and revenue-yielding sale through to the end and make a price in advance which will work on a continuous basis. The practical experience of price administrators has developed a maxim to the effect that one cannot win back by subsequent price reductions the customers initially lost through setting the price basis too high.

Hence, we insist that pricing for full sale must be an inseparable part of planning for full-scale production.

The notable progress that has been made among business leaders during recent years toward accepting the idea of low-price policy as meaning low margins per

unit of sales encourages the hope that in the not distant future there may be more general realization that the same principle applies at the next step also and that a low rate of profit on *fully and continuously employed capital* is the means of achieving maximum total earnings in the long run to the proprietary interest. But it is quite possible that conditions at the close of the war may retard such a development rather than advance it.

All the encouragement and guidance vouchsafed by the Committee for Economic Development or other agencies to businessmen all over the country to prepare for a period of business activity after the war undoubtedly fortify us against the possible onset of depression due to the lack of specific planning to guide reconversion activities or the presence of great uncertainty as to which way the cat is going to jump. But with this hesitation overcome, there is a no less serious danger that confidence itself, without sound understanding of the forces involved and the proper methods for their control, may lead to a short spurt of hectic activity followed by a collapse as severe as that of the thirties, perhaps even more devastating. The "rip-roaring, hell-raising, risk-taking economy" which Mr. Hoffman envisages for the post-war period might take on the character of previous excesses in times of easy spending or curtailed supply. Such a result would follow from charging all the traffic will bear in a period when long-deferred consumer wants and abundant consumer purchasing power are released into a market which is still not back to normal peacetime production. In the first few years after the close of the war, reversion to easy-going and short-range interpretations of the profit principle will be easy and to many business men will doubtless seem "smart."<sup>20</sup>

<sup>20</sup> The writer has been told by several informed persons that there is

It is being urged in many quarters that wartime price controls be retained for some years after the war as a safeguard against just such an outcome. It is still much too early to say whether our price control machinery will stand up and gradually acquire greater effectiveness or whether it will break down even before the end of the war. Assuming, however, that it does continue with at least reasonable efficiency while we are as much concerned as we are in doing whatever will help win the war, it seems clear that there will be a strong urge to throw off its restraint when peace comes. Even if this is not done, price control will undoubtedly encounter yet greater technical difficulties in dealing with the types of goods (many of them novel) to be dealt with in the postwar market and also increased resistance to enforcement at a time when war weariness and disgust with all controls associated with the war period will be widespread. Hence it is the part of wisdom now to get as much clarification as possible of the issues which confront management and a strong resolution on the part of business executives to deal with these situations soundly and firmly within their own areas of price control or influence.

#### FULL EMPLOYMENT THROUGH LOW-PRICE POLICY

This brings us back to the issue of finding a working criterion for the price-making decisions of the individual firm in conjunction with the production program being promoted by the Committee for Economic Development, the Chamber of Commerce of the United States, and others. It must be one which will give maximum

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a considerable wing of business opinion that looks forward to a period soon after the war in which they expect and are preparing to make the last big "killing" in the way of private profits before private business is taken over by the state. "After us, the deluge."

assurance of avoiding a quick postwar boom and early collapse. It must organize full production and current sale of product on a permanent basis of balanced adjustment between necessary cost and mass purchasing power. Such is the character of the "low-price policy" expounded in this book. The specific criterion which it offers to the executive of the individual firm is that of passing technological gains on to the consumer in the form of lower prices. By this method he systematically and dependably translates private enterprise into higher efficiency and this, instead of being dissipated in unemployment (the same volume of product with less labor) is fruitfully realized in larger national product and higher scales of living for everyone (more goods with the same labor—that is, the total labor force).

Engineers and scientists on every hand are informing us that technical processes have been advanced in the two or three years of intensive war effort by as much as they would have been in a decade of ordinary development. It is a matter of common knowledge, too, that older workers have had the barnacles of depression scraped off and new workers have been expertly selected, trained in the latest practices, and organized under novel short-cut processes. The exigencies of war have brought about the scrapping of roundabout and make-work methods of marketing. Here is a tremendous total of technological progress whose practical reality has been demonstrated in the "pilot plant" of all-out war. The real question is whether we are going to realize these technological gains in the future under the conditions of full-scale peace operation or let them go to waste through our failure to parallel the technological skills with similar skills in conducting our economic processes.

It should be evident that these technological gains do not exist or at least do not come to complete realization except under conditions of full-scale operation. Nor, as was pointed out in Chapter V, can they be achieved as a net addition to profits. They cannot be made to bear full fruit except as part of a complete process in which the net gains accrue as higher real incomes to the workers of all grades or as a higher general standard of living to the masses.

We thus surmount the difficulty of translating the criterion of full employment—clearly tenable and indeed obvious for the economy as a whole—over into terms operationally applicable to the individual company. Mere confidence in their own ability to provide jobs will not be enough to assure permanent success if the companies continue a scheme of operation under which some substantial part of the current proceeds is drawn away from the stream of actively flowing national income into the by-waters of hoarded capital or unutilized plant. This will start again the spiral of labor saving *alias* wasting which will mount and mount until massive unemployment and widespread underconsumption bring the economic system again to a condition of stagnation. Low-price policy, on the other hand, will guide the action of individual firms constantly back toward the norm of full employment and away from the production restriction and unemployment that grow out of conventional applications of the principle of profit maximization under conditions of administered prices.<sup>27</sup>

The individual firm can, if its executives apply themselves sincerely to the task, ascertain much more ac-

<sup>27</sup> It might be observed that this is the criterion by which the business executive with a measure of price jurisdiction achieves the closest counterpart to the automatic adjustments of a theoretically perfect competitive market.



curately than any public agency the occurrence and magnitude of efficiency gains and devise the most effective means of translating these gains into a commercially workable price structure.<sup>28</sup> To this end they must to the best of their ability—using both analytical and experimental methods—ascertain the amount of increased efficiency effected by each change in technique and pass these technological gains on promptly and fully through reductions in consumer price.<sup>29</sup>

Of course, no one can say today with any degree of confidence whether the general following of low-price policies by industrial and mercantile concerns after the war would mean lower dollars-and-cents prices. That issue is inextricably involved with the whole problem of inflation, whether engendered by government fiscal policies or by the spiral enhancement of costs as a result of farm bloc pressures and union boosting of wage rates.

<sup>28</sup> Actual price marking partakes of the nature of an art, however solidly its foundations may be laid in scientific analysis. For a studious businessman's portrayal of practical price-making problems in the multi-product firm, see E. Stewart Freeman, *The Industrial "Family" of Prices*. (This will appear as App. D. in the bound volume of this book.)

It is evident too that if a thoroughgoing application of this principle of price making were to be made as of any given time, it would have not merely to consider the passing on of new efficiency gains but also to reconsider existing price structures to ascertain the points at which these structures are defective because of the failure at earlier dates to pass on efficiency gains when they were introduced (if these had not subsequently been adjusted through such competition as might exist). This, as was pointed out in an earlier section in this chapter, would presumably involve revaluation of assets.

<sup>29</sup> Both to the industrial or commercial consumer and to the domestic or final consumer. Obviously, the gain to be passed on means the net gain after proper maintenance charges have been made for the equipment through which the gain in efficiency is effected and no less the research organization through which further efficiencies are to be sought. How large this latter provision shall be and whether it can be most effectively and economically provided through private companies or through tax-supported public agencies is of course a matter of judgment, with considerable differences of view.

Even assuming that we "hold the line" with utmost tenacity from now on, many businessmen are disposed to take the position that tax requirements and wage exactions have already absorbed all the gains of technological progress and perhaps more. On this premise, they argue that actual prices after the war will have to be higher rather than lower than prewar prices.<sup>30</sup>

In this connection the reader should remember what was said in the introduction of Part II to the effect that, under conditions of a rapid advance in the general price level, dollars-and-cents prices might be somewhat higher even when a low-price policy was being consistently followed. The writer, however, is by no means convinced that substantial decline even in money prices is precluded if the issues of the postwar decade are faced with understanding and courage. Business could well afford to pay taxes even that trenched on capital surplus during a few transition years in the interest of maintaining full private employment and demonstrating the possibility of curtailing the program of public spending. It is clear that if the tax burden for government activities carried by a fully-employed people cannot be borne by industry operating at full scale, the heavier burden of government seeking to compensate for the lack of private business activity could much less be borne by partially employed industry.

In these years at the end of the war also, the burden of proof would be upon private industry to show that the wage level (whatever the defects in the wage structure) is in fact so high as to require price advances

<sup>30</sup> For example, Dr. Charles F. Roos, addressing the controllers' conference of the National Retail Dry Goods Association in Chicago on June 17, 1943, advised that: "Retailers should count upon increases in prices. Their postwar planning should assume higher price levels." Associated Press Dispatch, *Evening Star* (Washington, D.C.) June 18, 1943.

even under conditions of full application of the available technological improvements. To be too high from the operational standpoint, it would have to be such as to give consumers more purchasing power under full employment than would be absorbed in taking the full product off the market at current prices. If, on the other hand, the mass consumers' market proved unable to absorb full product, then prices would be shown to be too high for even that wage level.

It is often argued that the individual employer cannot do much about unemployment because, under modern conditions of specialized production, even the largest companies cannot regulate or indeed influence to a significant extent the volume of purchasing power which would come into the hands of the particular persons who will buy their product. A word needs to be said therefore as to how our individual firm criterion of passing on technological gains embodies or implements our general criterion of full employment.

When an increase in efficiency (technological progress) takes place, more goods can be produced with the same labor or the same goods can be produced with less labor. If the price elasticity of demand is so high that the market will absorb the expanded product of the same labor force using the new techniques, at a price reduction equivalent to the cost saving, no problem develops. If, however, price elasticity is not great enough to retain all the workers in the given line of production, this is a price indication that such a scale of operations would constitute a poor allocation of resources. But if the price is lowered by the full amount of the net efficiency gain (including possible savings in selling cost) the additional purchasing power thus left in the hands of consumers constitutes a demand for a like amount of labor

to produce other consumer (or, through the more roundabout savings channel, producer) goods. Thus starting from a full employment position, a general application of low-price policy would effect the fullest possible safeguard against unemployment. Starting from a position of underemployment, the revision of the price structure to conform to this principle would promote progressive re-employment up to full-scale use of available labor.

A knowledge on the part of each individual firm that all other firms were releasing needed purchasing power into the general consumer market, instead of trying to impound an excess share of the product under their own control, would reduce the sense of business uncertainty which in the analysis of both businessmen and economists constitutes not only the occasion but also the economic justification for large profit margins. The maintenance of a self-sustained system of private business without dependence on government subsidy or financial supplementation depends on internal confidence in the individual firm that it has a sound criterion of operation and external confidence that a major proportion of other business concerns are ordering their affairs by substantially the same criterion.

What are the prospects that such a common understanding of the basic solidarity of interest that runs through our business world can be achieved and put in practical operation? That issue constitutes the subject of inquiry in Part III of this book.

### CONCLUSIONS

We began this chapter with an examination of the criterion of price-making traditional among administrative officials of private capitalistic business, namely

maximum profits for the owner. We noted that this criterion might in practice be interpreted as widest margin per unit of product, highest rate of profit on invested capital, or largest total profits over a period of time. As to these three formulations of the profit criterion, we concluded that:

1. Even a monopolist quickly finds that the *profit margin* must be held down to the point where unit profit times volume sold gives him the highest rate of proprietary return during a given operative period. Unit margin drops into an incidental position in formulating price policy.

2. Progressing thus to the criterion of maximum *rate of profit* for the owners brings the conflict between short-run and long-run results to the forefront of managerial consideration. If profits are to be kept at the most favorable rate, businessmen must bear in mind the repercussions which current drafts upon the purchasing power of the market (made by way of price setting) and current disbursements of purchasing power (made by way of wage, interest, and profit payments) have on each other and on overall prosperity. A lower rate of profits for a given year or other period may have to be accepted in the interest of maintaining continuity of operation and the largest ultimate opportunities for profit making.

3. The only tenable formulation of the criterion of maximum profits for owners as a whole must be as great *total profits* as can be produced over an indefinitely extended period, this to be attained through the harmonious adjustment of prices of products, workers' cash incomes, and payments to proprietary and loan capital. Both margin per unit of product and rate per unit of investment at a given time must be subordinated to this ultimate objective.

Since accounting figures are the idiom in which the businessman normally thinks, the terms in which he visualizes profits (or losses) is as increase (or decrease) of net asset values. As a result:

4. The capitalized expression of a previous earning rate or future prospect of such a rate, once written into the books of the company, becomes a figure to be defended. It frequently supersedes maximum total profits in the long run as the policy-making criterion of the businessman. Such year-to-year valuations are closely related to the rate of profit on proprietary capital during the given year or a relatively short term of years. Hence, there is a strong tendency to (at least) maintain posted asset values by price policies designed to uphold a high profit rate secured by limitation of output, with little regard to the ultimate results of such restriction. Revaluations tend to be "too little and too late."

5. Such an effort may be successful for the individual company in the short run and even, as to certain companies, for a considerable time. But, accompanied as it is by the constant effort to enlarge profits of the individual firm through the introduction of technological efficiencies (labor-saving organization and equipment), it results in progressive unemployment for the economy as a whole. This unemployment dams up at the source the stream of production, which must be kept at full tide if the total of profits for business in general and for any large company of wide general market (as well as real incomes of workers) is to attain its maximum.

6. Thus full employment (outside a small "hard core" of idleness) must become an ultimate criterion of price policy along with the traditional one of maximum profits to the owners—the latter meaning the largest total of profits that can be cumulated over the years. The

two may be regarded as joint criteria—mutual maxima from full production—or as obverse and reverse of a single integrated concept of a successfully functioning economy.

7. The professional manager of the modern business corporation occupies a somewhat detached position as neither just an owner capitalist nor just an earner of highly skilled worker's income. His distinctive task is to resolve the conflicts of interest among his clientele of capitalists, workers, and consumers so as to promote a full stream of resource use under the most efficient techniques attainable. Even the most powerful manager of the largest corporation, however, is not the administrator of the economy. Nor is any individual firm capable of devising or executing a grand strategy of price and production decisions that will cause a fully employed people to have the allocations of purchasing power sufficient to take this total product steadily from the market and thus activate the continuance of high (and rising) production and high (and improving) consumption.

8. For the first time in our history, we are seeing local expressions of responsibility on the part of individual executives for the operation of the economy after the war coalescing into a somewhat comprehensive movement. Hope of success is based in part on the willingness and ability of the government to inject purchasing power to make up any deficiency in the flow from private business and in part on the belief that advance planning of techniques and markets will assure the venturing forth of a sufficient amount of private enterprise when peace comes.

9. There are at least latent reservations to the effect that such a solution will be rendered impossible by reason of the exactions of union labor and the burden of

federal taxation. To these fears it may be responded: (a) that the most promising way of holding wage rates to suitable levels is by providing continuous employment and increasing the purchasing power of money wages by lowering costs of consumer goods; (b) that the surest way of lightening the burden of federal taxation is to lessen the need for recourse to government supplements to private income by providing the highest level of mass incomes out of full-scale operation of private business and distributing the irreducible remainder of the tax burden over this maximum volume of productive operations.

10. To base the program of all-out peacetime operation on a mere sentiment of confidence in the power of the "provident state" to maintain the flow of purchasing power is to rest upon a broken reed. To base it on confidence in the ability of private business to maintain a self-sustaining flow is to rest upon a substantial pillar of economic support. But even this is insufficient unless it is buttressed by a rational and well-understood principle of price relationships through application of which such a self-sustaining flow can be brought about and made permanent.

11. The technique of management which is fundamental to such an adjustment consists in passing on the net gains of technological progress promptly and fully in the form of lower consumer prices (including such undistributed gains of the past as it is still possible to identify and readjust). This criterion is peculiarly adapted to the individual firm because it is there that the new efficiency is contrived and can be most accurately estimated in prospect and measured in subsequent experience.

12. The postwar period of business reconversion will



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furnish a period of a few years in which there will be excellent opportunity for the adoption of this criterion by individual firms as the practical means of applying the general criterion of full employment. It will be a period in which it is of paramount importance to the continuance of private business that a working formula be found and mastered by responsible executives. But it will be a period also when the temptation will be strong and opportunities great to follow easier but ultimately destructive courses.

Throughout this chapter, the writer has had to contend with an expositional difficulty which he could find no way of meeting satisfactorily. It has seemed necessary at many points to talk of businessmen as accepting lower profits, or lower asset valuations, whereas there is every reason to suppose that in a majority of cases the courageous and consistent pursuit of the policies outlined would eventually produce a larger flow of profits and better sustained capital values. The matter might be stated in the form of a paradox by saying: valuing assets at a lower figure would make them more valuable, and willingness to accept smaller profits would make enterprises more profitable. Stated from the other point of view, insistence on big-profits-or-“no-sale” means that reaching for an unduly large increment to one’s property may entail as great or greater decrements from property already held. These phenomena, though denied or obscured in the calculus of many a corporate accounting department, still lie deep in the accumulated wisdom of the race, recorded in the story of Midas, in the fable of the dog with a bone who saw his reflection in the stream, and many others.